

**CONCURRENT RESOLUTION ON THE
BUDGET FOR FISCAL YEAR 1995**

HEARINGS

BEFORE THE

**COMMITTEE ON THE BUDGET
UNITED STATES SENATE**

ONE HUNDRED THIRD CONGRESS

SECOND SESSION

DEFENSE OVERHEAD WASTE AND MANAGEMENT

MARCH 3, 1994—VIEWS OF GENERAL ACCOUNTING OFFICE AND
DEFENSE CONTRACT AUDIT AGENCY

**REVIEW OF THE DEFENSE DEPARTMENT ROLES AND
MISSIONS**

MARCH 9, 1994—CONGRESSIONAL BUDGET OFFICE AND PANEL OF
DEFENSE EXPERTS

**THE PRESIDENT'S FISCAL YEAR 1995 DEFENSE
BUDGET REQUEST**

MARCH 9, 1994—DEPARTMENT OF DEFENSE



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(II)

THE PRESIDENT'S FISCAL YEAR 1995 DEFENSE BUDGET REQUEST

WEDNESDAY, MARCH 9, 1994

U.S. SENATE,
COMMITTEE ON THE BUDGET,
Washington, DC.

The committee met, pursuant to notice, at 10:04 a.m., in room SD-608, Dirksen Senate Office Building, Hon. Jim Sasser (chairman of the committee) presiding.

Present: Senators Sasser, Conrad, Dodd, Murray, Domenici, Grassley, Bond, Brown, Gorton, Gregg.

Staff present: Larry Stein, staff director; and Randy DeValk, assistant director for national defense.

For the minority: G. William Hoagland, staff director; and Roy Phillips senior analyst for national defense.

OPENING STATEMENT OF CHAIRMAN SASSER

Chairman SASSER. The committee will come to order.

This morning, the Senate Budget Committee continues its hearings on the Administration's budget for fiscal year 1995, and I want to welcome as our witness this morning the distinguished Secretary of Defense, Dr. William Perry.

Secretary Perry is one of our most able and dedicated public servants. He has many accomplishments and many honors in the defense arena, and they stretch over 3 decades. He is a consummate professional in the area of defense policy.

We all look forward to his testimony this morning with great interest, but before moving on to his testimony, I think a few observations might be in order here this morning.

We are reaching the end of the 20th Century, and our country is trying to meet many new challenges, but perhaps none as far-reaching as meeting the challenge that has been presented to us by the end of the cold war and by the disintegration of the old Soviet Union, our old nemesis that is no more.

Last year the Congress passed the Nation's first post-cold war budget. It was a budget that no longer clung to a world that has gone by, but reflected many of the changes that have occurred since we embarked in the 1980's on the largest peacetime military build-up in the Nation's history. I might say, parenthetically, that some of us feel that we are still paying for that enormous military build-up of the 1980's through continued wrestling with the deficit and interest payments on the National debt.

We have charted a new course with this Administration that is guided by our commitment to defense readiness, but, at the same

time, to fiscal responsibility, and my advice is that we should follow the course, "Steady as she goes," and stay steady in the boat with this new policy.

In my view, the Administration's budget request for the Department is reasonably fair and meets the task at hand. In fact, my only reservation is that it exceeds the task at hand, and I am not one who is persuaded that we are spending too little on our military establishment.

In passing, I might observe that if we are spending too little on defense, it certainly seems odd to me that we can afford the luxury of \$18 billion over the next 5 years for the Ballistic Missile Defense Initiative. That strikes me as the equivalent of spending billions of dollars on a vaccine when the threat has largely become nonexistent.

There has also been a great deal of rhetoric and breast-beating over a supposed \$20-billion shortfall in the defense budget. I say supposed shortfall because I don't believe for a moment that this gap exists. The gap is nothing more than the difference between projected priorities and constrained resources. The same difference exists in virtually every other area of the budget, all of which are equally affected by economic conditions like inflation.

Anyone who seriously studies this budget knows that there is no funding shortfall in the defense budget for fiscal year 1995, and again, there is always the question in defense, as there is everything else, of how are we going to hit the out-year targets. However, we will hit the out-year defense targets as we have been hitting our discretionary targets for 5 years. We will reassign priorities within the defense number. We will terminate some programs, shave some back. That is what we will have to do.

However, having said that, I would also point out that our commitment to fiscal responsibility implies that we must bring greater efficiency to all segments of government, including the Department of Defense, and the American taxpayers expect no less of us or the Department.

Mr. Secretary, all of your statements and actions indicate to me that you are uniquely qualified to accept the responsibility of bringing greater efficiency to the Department of Defense and to give the taxpayers of this country a dollar's worth of defense for a dollar's worth of money spent.

Unhappily, the committee's hearings last week on contractor overhead abuse in the Department of Defense pointed out in shocking and stark terms that we can find additional savings in existing accounts without sacrificing one iota of readiness.

Based on this hearing, I believe that an additional investment in DOD's audit functions, perhaps from a cold war relic like ballistic missile defense or even the new aircraft carrier, could produce enormous savings for the American taxpayers. That is an investment worth exploring, I think, in much greater detail.

So, in conclusion, Mr. Secretary, I want to commend you and your subordinates at the Department of Defense for all the hard work that has gone into producing this budget request. I think it reflects a keen appreciation of the realities of the world situation as we presently see it. It reflects a new awareness on the part of the Department of Defense towards a responsibility for deficit re-

duction. It also, I think, clings to a commitment of producing a defense that is second to none in the world.

We thank you for appearing here, and I want to turn now to our distinguished Ranking Member for any statements or comments he might wish to make.

Senator Domenici?

OPENING STATEMENT OF SENATOR DOMENICI

Senator DOMENICI. Mr. Chairman, might I just inquire, since there are a few of us in number in attendance at this moment? Senator Bond has some real time constraints, and I have conferred with Senator Grassley. I had wondered if after I deliver my opening, and I will make it brief, whether Senator Bond might take just a couple of minutes for an opening statement.

Chairman SASSER. I think that would be satisfactory. Our attendance is small this morning, and I think any Senator who wishes might make an opening statement.

Senator DOMENICI. Thank you, Mr. Chairman.

Mr. Secretary, good morning. It is good to have you here.

Secretary PERRY. Good morning, Senator.

Senator DOMENICI. I recall just before your confirmation a phone call that I received from you when you wanted to come visit me as part of your confirmation visitations, and I think I told you then, and I would like it to be in the record now at least in our committee, that I said I did not think you should waste your time because I was going to vote for you and thought your appointment was probably long overdue, and I was glad to be on your side on that one. I just want to tell you that since that time, you have certainly not let that confidence on my part down a bit, and I congratulate you for the job you are doing.

Secretary PERRY. Thank you very much.

Senator DOMENICI. Today we are reviewing the 1995 budget request for your Department. This request is for \$252 billion in budget authority, representing a real cut of 1 percent over last year. That comes on top of a 9-percent real cut in defense last year. So the combination of the two is 10 percent in 2 years.

The 1995 request is about 35 percent below the 1985 level and represents the 10th straight year of real cuts to defense budget authority, which ultimately controls people who look at outlays and wonder what we are talking about, but, ultimately, budget authority will get the programs and get the procurement in other things.

I note from my colleagues that this is the second time that I have had an opportunity to hear your presentation. I enjoyed it the first time, and I am looking forward to it again. I assume it will be somewhat different. I heard it in Appropriations not too long ago.

This budget, however, has a few things I think you ought to explain to us. It protects readiness with a hefty increase to the operations and maintenance account and a modest 1.6 percent pay raise for military personnel.

I note that operations and maintenance appropriations will decline, however, almost 13 percent in real terms between 1995 and 1999. 1995 is up, but over the 5 years, it is down dramatically. This occurs when more and more defense resources are being devoted to what traditionally are not counted as purely defense functions; for

example, humanitarian operations and environmental cleanup. They are both becoming very big ticket items; in particular, the cleanup. I know it is long overdue, but I think it ought to be put into perspective as to what is happening to the traditional O&M budget.

The story for procurement in R&D, the so-called investment account is mixed. The 1995 budget for procurement is \$43 billion, as I understand it, representing a real budget authority decrease of 5.4 percent, and this is nearly 70 percent below the cold war peak of 1985.

As you mentioned in your statement, your plan is to grow procurement in the out-years, and I hope you will explain that to us. The 1995 budget for research and development, commonly called R&D, is \$36 billion. That is a modest increase over last year, but I believe that a healthy R&D effort is absolutely necessary to maintain our technological edge, and I believe you feel that.

I note, however, that after 1995, the R&D budget begins to fall, and plans are for it to fall nearly 26 percent in real terms by 1999. I am concerned about these cuts in the out-years, and hopefully, you will give some attention to that, if not in your remarks, in your response to us.

Notwithstanding these concerns, I believe the bottom-up review strategy, if carried out and fully funded, is about the best we can do. I believe that if we are to maintain our credibility and influence in the world, we must maintain this force structure and a structure that can prevail under whatever circumstances we might face in the future.

I want you to know that I share the Chairman of the Joint Chief of Staff's assessment that the recommended force is, and I quote, "as lean as we dare make it," and that there is very little, if any, room for miscalculation. I think I have heard you say something like that, not in his words, and perhaps you might address that in some way before you leave this morning.

Thank you very much, Mr. Chairman.

Chairman SASSER. Thank you, Senator Domenici.

Without objection and pursuant to Senator Domenici's request, we will turn now to Senator Bond for a brief opening statement in view of the fact that he has another conflict.

OPENING STATEMENT OF SENATOR BOND

Senator BOND. Thank you very much, Mr. Chairman, Senator Domenici, and Mr. Secretary. I appreciate the indulgence.

Mr. Secretary, it is quite right that we are in a post-cold war era, and I think it does not follow from that, that there are no threats or dangers around the world.

In previous conversations and in statements of yours, I have heard you talk about the \$20 billion shortfall which, as I understand it, assumes that there is no substantial inflation or very low inflation which very few economists would accept as a working premise. I hope in your testimony that you will be able to reassure us that, if we follow the 5-year plan that you have laid out, we won't have a force either unable to fight two major regional contingencies or one that suffers severe readiness problems.

General Shalikashvili has said there is very little room for miscalculation. He has said that we could fight two wars, but when you look at the numbers, with only 11 active carriers to fight two major regional contingencies in the Gulf War, we deployed six carriers, two in transit, two in work-up for deployment, two in major overhaul, and it certainly does not seem to leave enough to fight another regional contingency.

The same is true for fighter wings. The bottoms-up review calls for 20. We are hearing talk of going down to 17½, but in the Gulf, we deployed 10½ wings, and I assume that if we were to engage in two major regional conflicts, we could not take all of the aircraft out of Korea, for example.

We are also concerned about the number of Army divisions, particularly if we have 25,000 troops to commit to Bosnia. I will be interested if you still believe—and I have heard different reports—as to whether we can still, with these budget figures, fight two major regional contingencies essentially at the same time or whether we are back to a fight-and-hold operation.

Finally, I know the Administration has stated its opposition to the measure introduced by Senators Domenici, Nunn, and myself to restore fire walls. You have stated that the President is committed to these budget numbers.

Mr. Secretary, I think the problem is Congress, not the President. The House Budget Committee has already cut the defense budget, and there is going to be another amendment to cut further. Given these developments in Congress, I hope that you would reconsider your position on the fire walls, and I will look forward to your testimony.

Mr. Chairman, I thank you very much for the time.

Chairman SASSER. Thank you.

Senator DODD, do you have any opening comments this morning?

Senator DODD. I don't really, Mr. Chairman, but I just want to congratulate the Secretary on the job he is doing. I look forward to working with you, and the Secretary, and the other members of the committee on these critical issues.

Secretary PERRY. Thank you, Senator Dodd.

Chairman SASSER. Senator Grassley?

Senator GRASSLEY. Mr. Chairman, let me ask you your desire. I have got about 7 or 8 minutes of remarks. I can either make them now or during my first questioning, but I want to make sure that I have got enough time to reserve to state what I have to say.

Chairman SASSER. I would like to get to Secretary Perry as soon as we could, Senator Grassley. So, if you could reserve that until that time, it would be fine.

I think Senator Conrad was here next, if I am not mistaken. Do you have any opening comments this morning, Senator Conrad?

Senator CONRAD. Mr. Chairman, if you would prefer that we withhold until the questioning round, I would be more than pleased to comply with your wishes.

Chairman SASSER. Senator Murray indicates that she also is agreeable to that. Thank you very much.

We will turn now to Secretary Perry because I understand his testimony is going to be fairly extensive this morning.

Mr. Secretary, we look forward to hearing your testimony and your observations this morning.

Senator GRASSLEY. Can you ask how long his testimony is going to be?

Chairman SASSER. I certainly can.

How long will your testimony be?

Secretary PERRY. I would estimate 15 to 20 minutes.

Chairman SASSER. It would be 15 to 20 minutes.

STATEMENT OF HON. WILLIAM J. PERRY, SECRETARY, DEPARTMENT OF DEFENSE; ACCOMPANIED BY JOHN HAMRE, COMPTROLLER, DEPARTMENT OF DEFENSE

Secretary PERRY. This testimony this morning is not going to be the usual budget testimony where we present stacks of programs and figures. Instead, I am going to try to focus on the strategy underlying the preparation of the budget in the hopes of elevating the debate on what the defense budget is all about.

It seems to me when I became the Secretary that the most powerful tool that I had for implementing defense strategy was the budget and, therefore, I ought to focus my attention on the budget and try to shape the budget, so that it reflected my priorities for the Department.

I think the reasonable thing to do, then, in discussion with this committee today, is to give you what my priorities and lay out the rationale for the choices that I made.

There should be no mistake about it. This budget is about choices. I am not here today to argue whether we should have a higher or a lower top line. I am here to discuss the choices I made for allocating funds within the top line.

There is not enough money to cover every option, to hedge every bet, and, therefore, our preparation for the budget was about choices, how we allocate them. I want to start off, then, by taking it from the top line down to how we allocated to the four major elements of funding within the budget: the personnel account, the R&D account, the procurement account, and the readiness or the O&M account.

I will tell you the rationale we used to read those choices, and to do that, let me then give you the underlying themes which we had before us when we prepared the budget and which I will now organize my discussion around.

These are the five themes which my discussion will follow this morning. The first is that this budget implements the bottom-up force structure.

FY 1995 BUDGET

- Implements the Bottom-Up Force Structure
- Protects a Ready-to-Fight Force
- Redirects Modernization Program
- Starts Doing Business Differently
- Reinvests Defense Dollars

Senator Bond already asked the question, does this budget implement the bottom-up force structure to fight two major regional contingencies. The answer to that is yes, and I will explain that in more detail as we go forward.

Second, it does protect a ready-to-fight force, and I will give you some discussion on how we made our decisions about protecting readiness in the budget.

The third point is that it dramatically redirects the modernization program with an emphasis, as you will see, on sustaining an R&D base, while making very deep cuts in our procurement account. I will explain that to you and the rationale for it.

The next point is that we are doing business differently. I should say that this is not so much a matter of choice, even though I do believe it is the best thing to do, but with a budget which is being cut over a 10-year period, about 40 percent in real terms, we had no option but to do business differently. We cannot sustain the force structure, the overhead structure, the whole concept of how we did business during the cold war. I will describe to you in some detail specifically what we are doing along that line.

Finally, as this defense budget goes down, some of those dollars are being reinvested. A large portion of them are being reinvested in the rest of the Federal budget, but some of them are being reinvested within defense, and I will explain that to you.

Let me take the first point, then, which is implementing the bottom-up force structure. This second chart describes to you how the force structure has evolved from its cold war base, and we have here 1990 as an example here, to the bottom-up review. In between these two, you will see in the third column the 1995 force structure. This is the force structure which this budget will take us to.

Force Structure

	<u>Cold War Base 1990</u>	<u>Base Force</u>	<u>1995</u>	<u>BUR PLAN</u>
Land Forces				
Army Active Divisions	18	12	12	10
Army Reserve Component Divisions	10	8	8	5 +
Marine Corps (3 Active /1 Reserve)	4	4	4	4
Navy				
Ship Battle Forces	546	430	373	346
Aircraft Carriers				
Active	15	13	11	11
Reserve	1	-	1	1
Navy Carrier Wings				
Active	13	11	10	10
Reserve	2	2	1	1
Air Force				
Active Fighter Wings	24	15.3	13.0	13
Reserve Fighter Wings	12	11.3	7.5	7

If I take one item, for example, Army active divisions, we go from 18 during 1990, the bottom-up review calls us to go 10 divisions, and in this budget which is submitted to you, the 1995 budget, we will be down to 12. So we still have some substantial cutting to do yet in the Army. Two more divisions need to come out of the Army after this budget based on the bottom-up review plan.

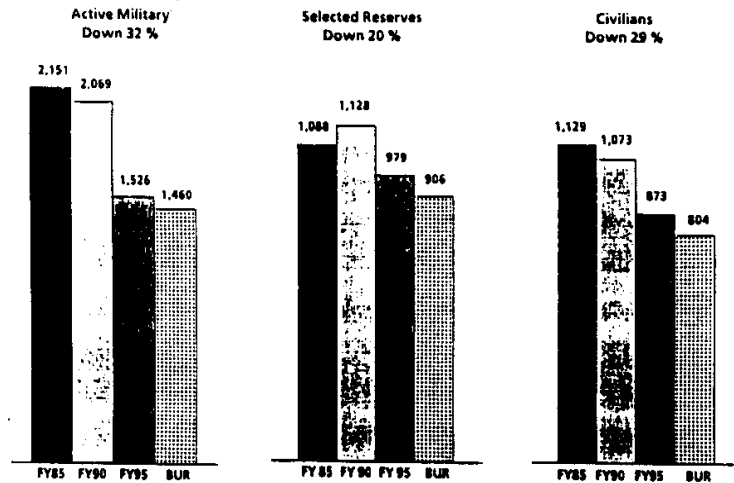
Let me go to the Navy. You can see the 546 ships in 1990; the bottom-up review calling for 346. I would point out to you the Navy is almost there in this budget. We are down to 373 in this budget. We have almost achieved the goal of the bottom-up review in the 1995 budget.

Going to the Air Force, there are 24 active fighter wings and 12 reserve fighter wings in 1990. That has called for a total of 20 instead of a total of 36 in the bottom-up review, and you will notice that we are virtually there in the 1995 budget. We are down to the number of active wings, 13, and we are almost down to the number of reserve fighter wings.

Each of the services made a different judgment about the rate at which they would converge to the bottom-up review, but in the 1995 FYDP that is presented to you, you will see that all of them achieve the bottom-up review force structure. However, some of them achieve it sooner than others.

The next chart reflects how that force structure gets translated into personnel levels. In the left-hand column, you see the active military, which will be down 32 percent from fiscal 1985 to the bottom-up review, going from 2.15 million personnel in the active services to 1.46, about a one-third reduction.

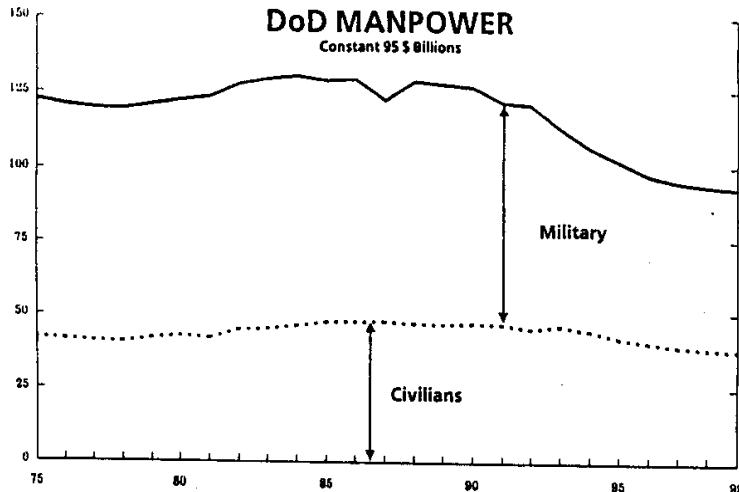
MANPOWER LEVELS (End Strengths in thousands)



Notice that in fiscal 1995, the budget submitted to you, we are down to 1.53. Again, the turbulence being caused by this decrease in personnel will be almost over by fiscal year 1995. We have about a year of reduction, mostly in the Army, to go in fiscal year 1995. The downsizing in the Navy and the Air Force will be virtually finished by that point.

If I go over to civilians, I would notice that there is a comparable reduction in DOD civilians with a reduction of 29 percent, and that also in fiscal year 1995, you will see that reduction is almost completed.

If I translate personnel into dollars, we see that in the next chart. The interesting thing about this chart, I believe, is that it reflects from 1975, the last 25 years of this century. From 1975 to 1990, we had in constant dollars, essentially, flat expenditures on personnel. All of the reduction and spending in personnel is occurring during this decade, and you see a substantial reduction from 1990 down to the end of the decade. That amounts to about something in excess of \$30 billion will decrease in personnel expenditures during the period.



I want to pause here for a moment to say that the last time we had a reduction in the top line of the defense budget of this extent, which was during the 1970s after the Vietnam War, we made a very different choice on how we were going to affect the judgment. There we maintained force structure. We maintained personnel. We maintained the cost of personnel. In the face, then, of the declining budget, what we had to do was take it out of readiness and take it out of modernization, and we did that.

Chairman SASSER. Mr. Chairman, looking at your chart there, if I may just interrupt for 1 second, there appears to be considerably more reduction in the active military than there are in civilians. Is that an accurate statement?

Secretary PERRY. In terms of percentage of reduction, it is 32 percent in the active military and 29 percent in civilians.

Chairman SASSER. I am just curious.

Secretary PERRY. It doesn't look like that on the chart, I agree, but the numbers which are in greater detail in the previous chart shows we are reducing from 1.13 million civilians to 804,000, which is about a 30-percent reduction.

Senator DOMENICI. Mr. Chairman, I am wondering if we can accommodate him in some way. This seems very difficult for him to testify. He has got to turn his head around to see those charts.

Secretary PERRY. That is all right. I will look at the charts here. That will work all right.

The two charts reflect different factors. The first chart is the number of personnel reduction, 29 percent, and the second one is the reflection on the dollar decrease.

With that \$30-billion-or-so savings in personnel, we concluded not to make that sort of a reduction in the readiness in the O&M account, which is a principal effect on readiness. Therefore, in the next chart, here we are reflecting how the decrease in dollars in top line gets carried into the O&M account.

I want to give you a caveat to begin with that we have no single line item in the budget or even a combination of several lines which really captures readiness. A surrogate we are spending on readiness is the O&M account, but I should caution you that there are many other factors in the O&M account besides readiness items.

With that caveat, though, let me observe that in fiscal 1995, the force structure is down 7 percent, but the O&M funding increases about 6 percent. The point I am making with this chart is that, while the force structure is going down, we are not taking the O&M account down proportionately to that because we are trying to preserve readiness.

PRIORITY ON READINESS

- While Force Structure is Down 7%,
O&M Funding Increases 5.6%
- Budget Fully Funds Service Optempo
- While Weapons Inventories Shrink,
Depot Maintenance Funding Increases 20%
- Steady Budget Levels for Recruiting

Since this O&M account comprises many factors, not including readiness, I have a few other points here which are more directly related to readiness. The first is the so-called Optemp, Operational Tempo budget. Here my point is that each of the Services requested Operational Tempo money, and this budget fully funds all of those requests.

Second, they requested an increase in depot maintenance funding of 20 percent. This is the fact which most importantly reflects the readiness of our equipment when it was called upon. We had a backlog in our depots, and so we dealt with that backlog by budgeting an increase in funding of about 20 percent for depot maintenance.

Finally, we maintained a steady budget for recruiting.

If I go on to the next chart, I see another way of reflecting readiness. This is taking the operating resources that are budgeted in this account and dividing them by the combat units which we have. This chart shows that from 1993 to 1995, the Army has budgeted operating resources, an increase of 14 percent per combat battalion, the Navy has budgeted an increase of 11 percent per ship, and the Air Force has budgeted an increase of 12 percent per aircraft.

ANNUAL OPERATING RESOURCES PER UNIT
(1993 = 100)

	<u>FY 1993</u>	<u>FY 1994</u>	<u>FY 1995</u>
<u>Combat Battalions</u>			
• Army	100.0	102.5	114.0
<u>Ships</u>			
• Navy	100.0	108.1	110.7
<u>Primary Authorized Aircraft</u>			
• Air Force	100.0	109.3	111.7

Senator DOMENICI. Mr. Chairman, might I clarify something?

Senator CONRAD [presiding]. Certainly. Yes.

Senator DOMENICI. What does that mean to add to an annual operating resources like that, 14 percent for the Army? Could you give us some examples? What does that mean, that 14 percent?

Secretary PERRY. This is John Hamre, our Comptroller. Let him join us on this.

Mr. HAMRE. In this instance, we are showing the most aggregate collection of dollars, and that is the total O&M account divided by the total amount of force structure combat power that is within each of the service categories. So this is everything. This is the training time. This is the training tempo.

Senator DOMENICI. Yes.

Mr. HAMRE. This is the spare parts maintenance, the replenishment of spare parts.

Senator DOMENICI. All right.

Mr. HAMRE. It is a composite picture or a composite figure.

I should also mention, these are in real terms. We have taken out the effect of inflation. So you are seeing a real activity increase over this period, sir.

Senator DOMENICI. Thank you very much.

Thank you, Mr. Secretary.

Secretary PERRY. Let me also add, Senator Domenici, that this also includes some items in the O&M account which are not related to readiness, and we will go back and talk more about them as we go on.

Senator DOMENICI. Sure.

Secretary PERRY. This is a very crude indicator, and it should not be looked at as a fine tool. The next chart also represents a crude indicator. It simply takes a total O&M account and divides it by the military end strength. For the Army, that has gone up 9 percent per person in the Army over the 2-year period; 9 percent in the Navy; and 17 percent in the Air Force. These are only to be rough indicators that show you that what we were doing in the 1970's, which was holding force structure constant while we took down readiness, we are not doing now; that as the force structure

comes down, the readiness account is not going down at the same level.

OPERATION AND MAINTENANCE
Costs Per Military End Strength
 (1993 = 100)

	<u>FY 1993</u>	<u>FY 1994</u>	<u>FY 1995</u>
• Army	100.0	96.9	109.4
• Navy	100.0	104.5	109.1
• Air Force	100.0	107.3	117.1

That was the principal choice we made. Now, how we made that choice is another issue, and that is each year when we put this budget together, the first action, the initial action is that the Secretary of Defense gives each of the Services guidance. On the basis of that guidance, each Service prepares its budget.

For the first time this year in the guidance, indeed, in the first page of the guidance, the Secretary stated that the first priority of each of the Services will be maintaining readiness. That is the first time that has ever been stated that way in the account.

To emphasize the point, we go on to say that if there is anything else in this guidance that conflicts with the readiness, then readiness may be traded off in favor of those other conflicts. So we have stated as clearly as we could to the Services that readiness is the first priority, and this is reflected in the dollars which were put into the O&M account.

Let me turn to modernization because we have a very different story in modernization. I have represented in this next chart the five criteria that Mr. Deutch used in putting together the readiness budget. First, it is that he sustains a strong science and technology base. I will demonstrate to you that we are doing that.

BUR--ESSENTIAL MODERNIZATION PROGRAM SUSTAINED

- Sustain Strong Science & Technology Base
- Continue Investment in Next Generation Weapon Systems
- Refocus Ballistic Missile Defense Program
- Sustain Strong Intelligence Program
- Preserve Key Elements of Industrial Base That Would Otherwise Disappear

Second is that we continue investment in a selected number of next-generation weapon systems; very, very few, as it turns out, but there are a few in here. The C-17, the F-22, and the V-22 are examples of new-generation systems that are fully funded in this budget that is submitted to you.

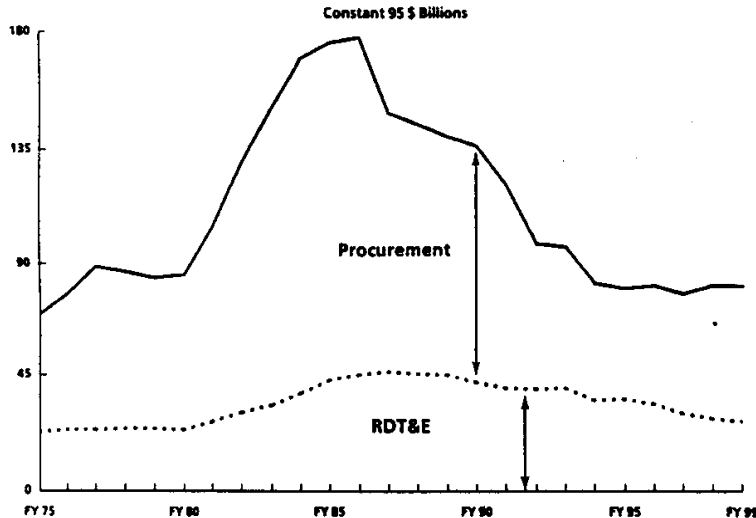
The third was refocussing ballistic missile defense program. Essentially, all of the funds that were previously devoted towards developing the next generation space-based defense system or continental defense system have been dramatically reduced, and what remains in this budget is an increased emphasis on developing, building, and deploying a theater ballistic missile defense program.

The next two items have to do with sustaining a strong intelligence program. We believe that in this uncertain world we live in, the last place we want to make cuts is in our intelligence.

Finally, because of the dramatic cut in the procurement budget, we have to take special measures to protect certain elements of the industrial base which otherwise would simply disappear, and I will make that point to you better by the chart that is coming up, two charts from now.

If I go now to the impact of those decisions on the modernization funding, this is, perhaps, the most dramatic chart in the presentation which shows you what is happening to the R&D and the procurement account.

MODERNIZATION FUNDING



It says that R&D, while it is going through a moderate decrease during the 1990's, still remains at a higher level at the end of this decade than it was during the end of the 1970's.

I was the Under Secretary of Defense for Research and Engineering during the late 1970s. So I have a full appreciation of what was in that R&D budget. That was the era in which we were developing the systems which were later used in Desert Storm. So we have a very good validation of the fact that you can sustain a robust R&D Program at that level of funding, and that is, essentially, the level we will be going down to towards the end of the 1990s.

In the procurement account, however, we have a very different story. We are cutting from the peak procurement in the mid-1980s. We are cutting more than $\frac{2}{3}$ of that procurement account out, and that will reach its bottom this year, fiscal year 1994, and essentially stay constant in fiscal year 1995.

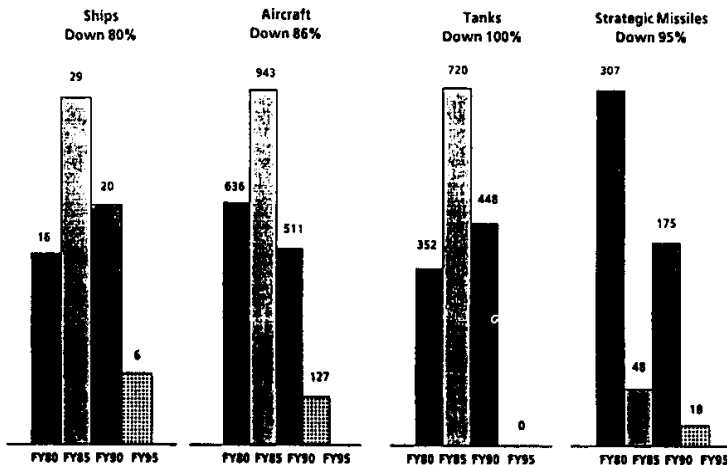
If you will look at that chart carefully, you will see that in the 3-out years in this program, 1997, 1998, and 1999, we have budgeted a moderate increase in the procurement account, and let me give you the rationale. First of all, we can make a major decrease in modernization simply because there are fewer airplanes, fewer ships, fewer tanks in the force structure because we have a smaller force structure. Therefore, you would expect a substantial decrease in this procurement funding.

This cut in 1993, 1994, and 1995 reflects more than that lower force structure. It also reflects the fact that, as you bring your force structure down, you have excess inventory for a number of years, and we are living off that excess inventory and will continue to live off it for another few years. By the latter part of this decade, we will no longer be able to live off it, and we now have to start modest rebuilding of the force at that stage, and that is why we have

indicated an increase in procurement towards the end of that period.

If we want to get the specific effects on the procurement, I go to the next chart. This shows you, in a rather dramatic form, the impact of this budget on the defense industry. This represents the market decline for companies that are in the defense industry.

HISTORICAL PROCUREMENT DATA



The first one shows ships from the peak of 1985 of building 29 ships a year. In the fiscal year 1995 budget, we are down to 6, which is about an 80-percent decrease in procurement of ships. Aircraft is from 943 to 127, which is an 86-percent decrease. Tanks are down from 720 to 0. This fiscal year 1995 budget includes no funds at all for the procurement of new tanks.

What is suggested by this chart is something which is felt by every company in the defense industry, which is a dramatic decline in the defense market, and that is a problem for companies in the defense industry. The problem I need to address, though, is what parts of that industrial base are important for us to sustain into the future and how do we sustain those bases.

Let me take the tank case, for example. Tanks are down 100 percent. We are procuring no tanks in fiscal year 1995. We want to retain the capability to build tanks. How are we going to do that? It is done by two different methods, one of which is in the 1995 budget. While there is no money for building new tanks, we have substantial funds for modernizing and upgrading the existing M-1 tanks to the M1A2 version. This will give us not only a greatly improved tank in our inventory; but also it will occupy key technical and production people at the tank factory and, therefore, engage their capabilities into the future. Second, we do have some foreign sales of the tanks, and that is another way of maintaining that capability.

Chairman SASSER. What did you say was another way, Mr. Secretary?

Secretary PERRY. Pardon me?

Chairman SASSER. The last part you said was?

Secretary PERRY. I said there are two methods of maintaining the tank capability. The first one is the upgrade program we have, and the second is the foreign military sales.

Chairman SASSER. I was afraid that is what you said.

Excuse me. Go ahead.

Secretary PERRY. I should make a point about the foreign military sales, which is regardless of how interested we are in maintaining our industrial base, the dominant criterion for determining whether any weapon system, including the tanks, are sold to a foreign government still is a national security decision, not an economic decision.

In the case of ships that are down 80 percent, we are maintaining our industrial base there by several different devices. First of all, in the case of cruisers, we are building sufficient ships to maintain several shipyards with that capability. In the case of nuclear submarines, that is not the case. Nuclear submarines, we are going from a force of just under 90 nuclear submarines to a force of just under 50. Therefore, we do not need to build submarines for the rest of this decade in order to maintain those force levels.

We have elected to build, and it is in this budget, another Seawolf submarine in order to sustain the capabilities for building nuclear submarines. That is a controversial decision. You may want to challenge the wisdom of that judgment. I will be happy to defend why we made that decision and the importance, I think, of keeping this in the budget.

Finally, in the case of aircraft, while our aircraft are down 86 percent, we continue to maintain both development and production programs for fighter aircraft, and I believe we will sustain our fighter aircraft base sufficiently with the programs in this budget.

We will lose the capability to build bombers in this budget, and we have made no provision for sustaining a bomber industrial base, and this budget may be challenged on that basis.

Chairman SASSER. Mr. Secretary, before leaving this chart, I note that you are continuing to acquire strategic missiles. What is the definition of strategic missiles? Are they ICBM's?

Secretary PERRY. Yes; Intercontinental Ballistic Missiles and submarine-launched ballistic missiles. This is as opposed to the air-to-surface missiles which we use on tactical aircraft or the air-to-air missiles which we use on tactical aircraft.

Chairman SASSER. Thank you.

Secretary PERRY. The 18 that you see reflected in that chart, we are building Trident missiles. That is the last strategic missile which we will build, and we have stopped production altogether of ICBM's, and the only intercontinental or strategic missile we are now building is the Trident missile.

If this previous chart reflected the imperative of doing business differently, this next chart tells you what it is we are doing to meet that imperative.

First of all, we have a major program underway—it says here to streamline, but I think it is fair to say to dramatically reform, our

acquisition process. We can achieve about half of that reform, I believe, by changing our processes within the Defense Department, and we have established process action teams in many different areas that are moving in that direction already.

DOING BUSINESS DIFFERENTLY

- Launches Campaign to Streamline Acquisition Process
- Launches Effort to Reform Financial Management System
- Provides Funding for Base Closures and Aid to Communities Losing Bases
- Provides \$5.7 Billion for Environmental Restoration and Pollution Prevention

The other half of the change requires some legislative change, and there are before the Congress today several different bills, two in the Senate and three in the House, that are proposing acquisition reform. I invite your support for these bills because, in order to get the full benefits of acquisition reform, we will need legislative changes.

I might say that the principal thrust of acquisition reform is to make the full national industrial base available to the Defense Department, so that the Defense Department is not limited to that rather specialized segment called the defense industry. We could afford to be limited to the defense industry when we had \$100 billion a year of procurement. Now that that has been decreased and is at a substantially lower level for the indefinite future, it is no longer prudent for the Defense Department to be limited only to the defense industrial base. So one of the objectives of acquisition reform is to integrate the defense industrial base into a National industrial base, so that the Defense Department has the entire national base available as a supplier.

The second imperative for doing business differently is to reform our financial management system. I can tell you that when I became the Deputy Secretary and had the responsibility for overseeing our financial management system and had a detailed review of it, I was appalled by the state of our systems and by the state of the financial processes we used. We do not have it in the Defense Department, here at the Defense Department, the biggest business in the world, and the financial management systems we use to oversee that are archaic and obsolete.

We have a major program underway to change that. I might say the regrettable part of this is that, while it can save us money in

the long term, it is going to require some investment in the short term.

The third bullet talks about getting our infrastructure down. That involves reducing civilian personnel, and it involves closing bases. In this budget, it includes some funds that are necessary to effect the closing of the bases. While over the medium to long term, closing bases will save us money, in the first few years after base closing, it is an expensive item, and this budget not only includes the ongoing expenses for the basis which were closed in 1993, but it makes an estimate of what bases might be closed in BRAC 1995 and includes some funds also for facilitating the closing of those bases not yet on the base closing list.

Finally, there is almost \$6 billion in this budget for environmental restoration and pollution prevention. This is one of the fastest-growing items of the defense budget. What is in this budget, the bulk of that \$5.7 billion, are clean-up items which we feel obliged to do because of law or regulation, and we believe we have, essentially, no choice in those items except a choice, perhaps, of timing of when we do them.

We have also included a small amount of money, discretionary money, for pollution prevention. This is a small investment now that we are making, so that my successor as the Secretary and his successor will not be faced with this \$6 billion a year for clean-up every year; that is, it is preventing the pollution which will lead to these heavy bills in the future.

The final increment of funding in this budget, if you go to the next chart, is called defense reinvestment. The biggest part of the decrease in the defense spending is going into other parts of the Federal budget, but there is \$3 billion of it which is reinvested within the Defense Department, \$2 billion of which goes to dual use technology investment. These are R&D Programs where we are sponsoring R&D that is useful to defense, and we are getting the contractors to cosponsor these programs, typically, by putting up 50 percent of the funding, so that they can use this same technology for application to commercial products.

**DEFENSE REINVESTMENT
AND ECONOMIC GROWTH INITIATIVES**
(\$ in Billions)

	<u>FY 1995</u>
Dual Use Technology Investment	2.1
Personnel Transition Assistance	1.0
Community Assistance	<u>0.2</u>
 Total DoD Programs	 3.3

This is a program that is intended to be a win/win program. It helps both the contractor do commercial development and the Defense Department in advancing R&D which is useful to defense.

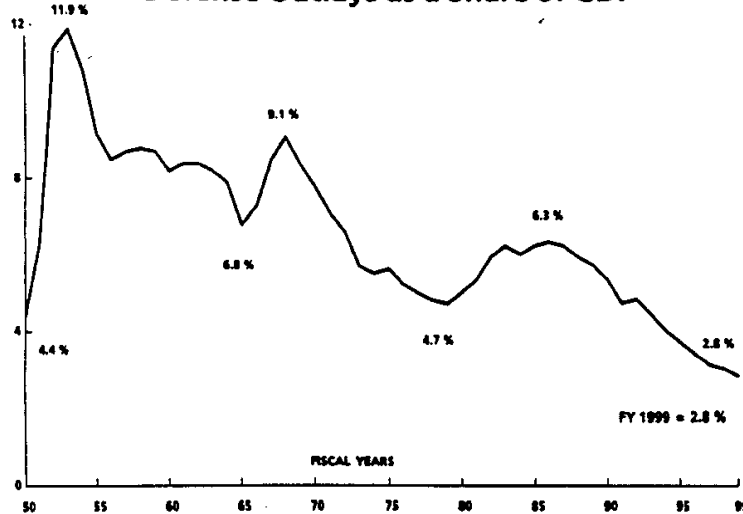
The key portion of this program is called the Technology Reinvestment Project, which was launched in the spring of this year and already has something under a billion dollars invested in it, and over the period of this 5-year program, there are several billions of dollars that would be invested in this sort of R&D.

The other two items here, personnel transition assistance and community assistance, are money that we invest to mitigate the problems that occur with the draw-down in defense and with pulling bases out of communities. These are funds to retrain personnel who are losing their jobs, and they are funds to assist communities who have bases taken out of the communities. This fund is primarily for assisting them in replanning and developing a re-use program to convert over into commercial use.

I talked about the defense reinvestment. I want to show you how this goes, relative to reinvestment, out of defense and into other aspects of the budget.

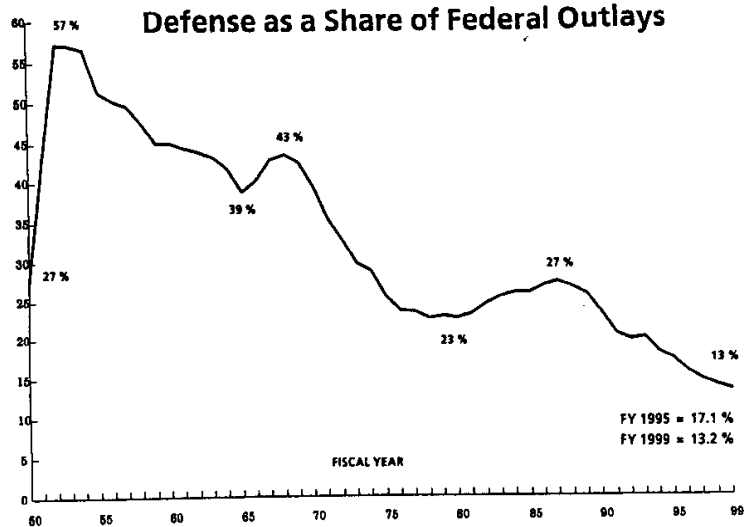
This next chart shows you the 50-year period, 1950 to the end of the century, defense outlays as a share of gross domestic product, and these are in real dollars. The interesting thing about this curve is there is a conical downward trend and that there are three major peaks. The first peak which shows defense as 12 percent of gross domestic product (GDP) was the Korean War. The 9 percent was the Vietnam War. The 6 percent of GDP was the peak spending during the Reagan defense build-up at the peak of the cold war.

Defense Outlays as a Share of GDP



In the FYDP we have presented to you, we project that going down to 2.8 percent of the gross domestic product by the end of this decade. The number for this fiscal year, fiscal 1995, is 3.4 percent, on the way down to about 2.8 percent.

Another way of representing that is the next chart which shows defense as a share of Federal outlays. This is now looking at defense as a part of the Federal budget, and we see 57 percent during the Korean War, 43 percent during the Vietnam War, 27 percent during the Reagan defense build-up, and we have that projected, going down to 13 percent by the end of this decade, which is, of course, the end of the century. The number for fiscal 1995 is 17 percent of the Federal budget. In terms of defense reinvestment, this represents the reinvestment from defense expenditures to other Federal expenditures.



The next chart now simply gives you the numbers for the FYDP. Fiscal year 1994, the year we are now in, is about \$250 billion, and fiscal year 1999, the end of this decade, it shows again about \$250 billion. So, in current dollars, we project for this 6-year period, essentially, a flat budget, which is to say that the budget will be decreasing by the rate of inflation during that period.

NATIONAL DEFENSE TOPLINE
(Current \$ Billions)

	1994	1995	1996	1997	1998	1999
BUDGET AUTHORITY						
DoD Military	249.0	252.2	243.4	240.2	246.7	253.0
DoE & Other	11.9	11.5	11.9	11.8	12.0	12.1
Total National Defense	260.9	263.7	255.3	252.0	258.7	265.1
% Real Change	-9.0	-0.9	-5.9	-4.0	-0.2	-0.3
OUTLAYS						
DoD Military	267.4	259.2	249.1	244.6	244.7	245.5
DoE & Other	12.5	11.5	11.9	11.8	11.9	12.0
Total National Defense	279.8	270.7	261.0	256.4	256.6	257.5
% Real Change	-6.0	-5.2	-6.4	-4.5	-2.7	-2.4

If you go down to the intermediate line that says "percent real change," you see the real change reflected then. There was a 9-percent decrease, as Senator Domenici has already pointed out, in

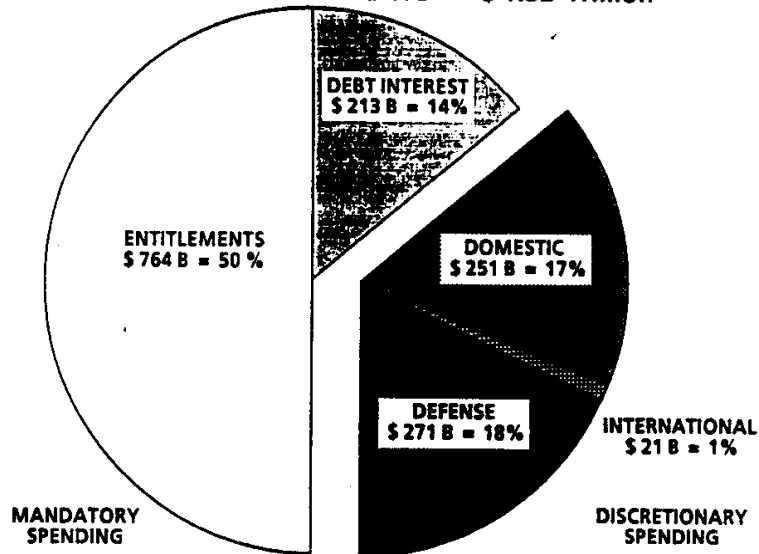
1994, just under 1 percent in 1995. We are reflecting about a 6 percent and a 4 percent decrease during 1996 and 1997. Then we project the budget flattening in 1998 and 1999.

If you reflect back to the chart which I showed you on procurement, which shows the procurement dollars starting to go up again at the end of the year, that is primarily what causes this flattening effect to take place in 1998 and 1999.

A final philosophical point here is that I represent this budget is more than a compilation of programs and dollars. It is a strategic investment plan and it is based on the bottom-up review. While you may or may not agree with every aspect of the bottom-up review, it does give us a common understanding. It gives us a language for discussing why we are doing what we are doing because it connects the strategy with the force structure and the cost.

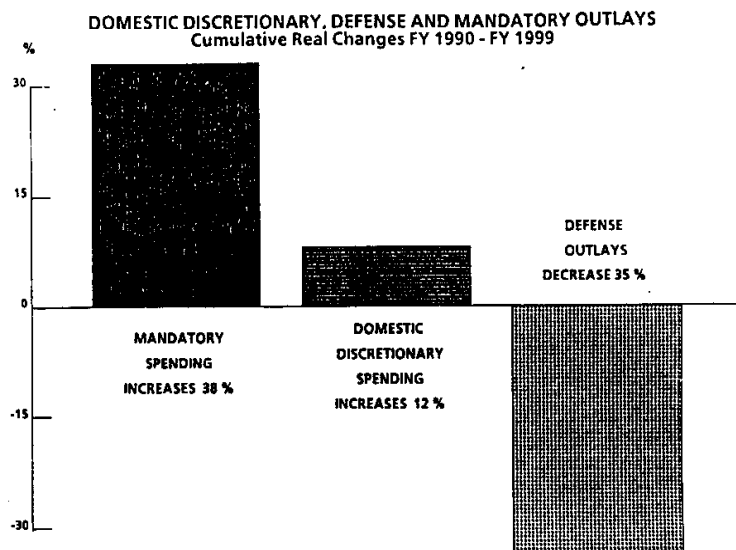
The last two charts, I am sure you have seen before, and I won't dwell on them. This shows that defense in the 1995 budget is actually just under 18 percent of the Federal budget. The next chart shows the change during the decade of the 1990s. I have talked several times about a major drop in defense spending during the 1990s. That comes to about 35 percent in real terms. That is the red chart at the bottom. There was a 35-percent decrease, during which period the mandatory spending increases have been about 38 percent and domestic discretionary spending about 12. So this gives you a relative flavor of how the overall Federal budget has gone during the decade of the 1990s.

1995 FEDERAL OUTLAYS = \$1.52 Trillion



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Mr. Chairman, that concludes my remarks, and I will be happy to field any questions which you would like to put before us.

Chairman SASSER. Thank you, Mr. Secretary.

[The prepared statement of Secretary Perry follows:]

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UNTIL RELEASED BY THE
SENATE BUDGET COMMITTEE

STATEMENT OF
THE SECRETARY OF DEFENSE
WILLIAM J. PERRY
BEFORE THE
SENATE BUDGET COMMITTEE
IN CONNECTION WITH
THE FISCAL YEAR 1995 BUDGET
FOR THE DEPARTMENT OF DEFENSE
MARCH 9, 1994

FOR OFFICIAL USE ONLY
UNTIL RELEASED BY THE
SENATE BUDGET COMMITTEE

STATEMENT OF SECRETARY OF DEFENSE WILLIAM J. PERRY
IN CONNECTION WITH THE FY 1995 DEFENSE BUDGET
SENATE BUDGET COMMITTEE
MARCH 9, 1994

Mr. Chairman, members of the committee, it is a pleasure for me to be here today to present President Clinton's fiscal year (FY) 1995 defense budget.

During my confirmation hearing, I laid out six responsibilities for the Secretary of Defense. One of the responsibilities is to prepare the annual defense budget that allocates resources and makes program decisions.

The budget is a powerful tool through which the Secretary implements defense strategy. Through the budget process, I as Secretary set my priorities for the Department. Today I want to talk about how this budget reflects the strategy we have adopted to build a post-Cold War Department of Defense (DoD). I want to share with you my priorities and lay out the rationale for my choices. For the budget is about choices. We could pretend that every decision was based on pure logic, but we know that is not so. Nor is there enough money to cover every option, to hedge every bet. I expect discussion, perhaps even challenges. It is time to open the debate.

Today I am presenting a post-Cold War budget. It reflects the realities of our inherited force structure. We have a quality force, but the size of the force structure is both a blessing and a burden. We have large stocks of top-quality equipment, which in FY 1995 continue to provide options regarding future modernization. We also have a force larger than we need, one that requires a few more years of downsizing, and an infrastructure that requires further shedding, a process which we have discovered has heavy up-front costs.

Defense Themes

(Chart 1) There are five major themes which I would like to highlight in this budget.

First, it implements the Bottom-Up Review.

Second, it protects a ready-to-fight force. It tells you what we have done to put reality into our rhetoric about readiness.

Third, it redirects our modernization program, taking advantage of our existing force structure while planning for the future.

Fourth, it starts to do business differently. There are serious fiscal implications if we do not manage better. Without

management changes, we will not have sufficient funds for the future. As it is, we know that we have to plus-up the procurement accounts in the outyears to begin the process of "recapitalizing" the force. If we fail to manage better, overhead will drain funds from other accounts. We will have no choice but to rob from readiness or increase the topline.

Finally, this budget reinvests defense dollars into other areas of the economy, including deficit reduction.

Post-Cold War Force Structure

(Chart 2) Let me begin with force structure. The Bottom-Up Review served as the heart of our force structure planning. The Review concluded that our basic force structure should be sized to fight two medium-sized regional conflicts (MRCs) nearly simultaneously, and it defined the minimum needed force structure. Additionally, we allowed the requirement for overseas presence to help size the force. The structure we proposed then, and which is supported by this budget, allows us to meet these requirements.

Our budget continues the drawdown begun by the previous administration and takes it to the BUR levels at the end of the Future Years Defense Program (FYDP). In some areas, we will reach these levels more quickly, an important factor since significant savings will accrue and be available to plow back into other investments. We are already close to the BUR level of four Marine divisions; we are getting close to 346 ships and the 13 active fighter wings. In other areas, we are on a more gradual glide path because we need to make the enhancements that will help us compensate for a smaller force structure. When we reach the BUR levels, the overall force structure will have come down about 30 percent from its peak in the '80's.

Manpower

(Chart 3) The overall manpower levels have come down as you would expect with the declining force structure. One notable change is the increased emphasis I have placed on reducing the civilian support structure in a way that is commensurate with the drawdown in military forces. This is a painful process, and we must continue to fund the programs that allow us to minimize RIFs. We must also adequately fund employee transition programs that permit discharged military personnel the best possible chance to find work in the civilian economy.

The good news in this process is that, with the '95 budget, we are almost at the end of the personnel drawdown. So the personnel turbulence which so heavily affects morale will be largely behind us at the end of the '95 budget year.

(Chart 4) During the Cold War the costs of manpower stayed about level. Now we are cutting deeply in this area. The savings from a smaller force structure are considerable, about \$36 billion. We are already realizing most of these savings. This is the prime example of a choice in priorities. We have chosen to cut force structure in order to preserve readiness. This is the opposite of the judgment we made in the 1970's when we maintained a force of 2.1 million people, but deeply cut the Operation and Maintenance (O&M) accounts. That approach led to the "hollow force" of the 70's. Instead, we have determined that we can effectively function in the post-Cold War era with smaller forces, if those forces are ready.

Priority on Readiness

(Chart 5) We are taking those savings and investing them in the Operation and Maintenance accounts as the most direct way to preserve readiness. While the force structure will decrease 7 percent between FY 1994 and FY 1995, we have increased O&M funding by 5.6 percent. We have also fully funded Service Optempo requests. We have also decided that even while weapons inventories are shrinking we need to increase depot maintenance funding by 20 percent. Finally, we are maintaining the budget levels for recruiting. FY 1994 was as good a recruiting year as ever in terms of numbers and quality, but we must counteract the popular perception that we can no longer offer full careers. We must resist the temptation to save dollars on recruiting.

These are areas where the Secretary of Defense can make his priorities known. I cannot go out and repair a broken airplane or ship, but I can make sure that the military services give readiness their highest priority. We even put this instruction into the front end of the fiscal guidance. The services were told that readiness is the first priority and that all other guidance could be traded-off if they needed to program funds for improved readiness.

(Chart 6) One of the challenges in making this sort of decision is to find ways to explain the effect that added funding for readiness will have. One of the best ways we have found is to look at the funding per unit of military activity -- the funds available to operate a plane, a ship, or a combat battalion. Through this measure we are able to show, by activities and capabilities in the field, the relative increase in funding we have provided for readiness.

(Chart 7) We can also look at the increase in funding relative to the manpower levels in each service. For example, you can see that the Air Force has chosen to increase its O&M relative to Air Force end strength.

This dollar emphasis on readiness translates into people's ability to do their jobs with high confidence of success.

Needless to say, increased funding for training and maintenance is important for morale.

Modernization Approach

(Chart 8) The next priority I have set for the Department, with John Deutch's help, is to redirect our modernization programs. Again, this decision is consistent with the strategy laid out in the Bottom-Up Review, which premised our two MRC strategy on force enhancements.

First, we will sustain a strong research and development effort. I firmly believe that we can and must continue to provide our forces the kind of advantage we had in Desert Storm. In the business world it might be called an unfair competitive advantage, but in combat it is called winning, and winning with minimum casualties. Additionally, a strong R&D effort is essential to provide a foundation if we ever have to reconstitute our forces.

Second, we need to continue to buy some next generation weapons. This is our commitment to the next generation of Americans. The C-17 is crucially important to the Bottom-Up Review strategy. We are also forging ahead with the F-22. But these are a select few programs.

Third, we have refocused the Ballistic Missile Defense Program to give first priority to theater defenses.

Fourth, have emphasized intelligence. We cannot dismantle it. The world is a dangerous, uncertain place, and many of the diverse threats we face today are difficult intelligence targets.

Finally, we want to preserve key elements of the industrial base that would go away if it were not for our support. This may be one of the most controversial decisions we have made, and I would be happy to discuss it at length.

(Chart 9) For the past twenty years the procurement budget has been on a roller-coaster ride. Research and Development has been more stable; it has come down some, but it is still higher, in constant dollars, than in the late 1970s when we developed the weapons used in Desert Storm. I want to maintain R&D at a robust level.

The most difficult choice we have made is on procurement, and this will be a point of contention for many with this budget. First let me say that we cannot sustain these low levels of procurement for long, and we are projecting an increase beginning after '95, when it goes up by 20 percent between '96 and '99.

(Chart 10) We plan to continue the drop-off in near-term procurement that started in the Bush Administration. We will go from 20 ships in 1990 to six in 1995, from 511 aircraft in 1990 to 127 in 1995 and from 448 tanks in 1990 to zero in 1995. The tank story is not a complete picture since we are doing some upgrade work, which keeps the industrial base warm, but the contrast to the recent past is dramatic.

There are two reasons for this drop off. First, we are projecting a much smaller force structure, down 30 percent. And even when we hit a steady state, we will have smaller buys than the past. Second, as our force size goes down, we can live off the inventory we built up for the Cold War.

The biggest challenge we will face during the transition will be fine-tuning the industrial base. Attack submarine forces is a good example. Based on a 90-sub force with a sub life of 30 years, the required build rate would be three per year. A projected 45-sub force would require only one-and-one-half submarines to be built per year. But as we draw down to that 45-sub level, we really have no need to build new submarines until after the turn of the century. The reason we have chosen to invest in a new Seawolf over the next few years is to keep the industrial base active at a minimum level until we need to start buying again at a steady-state level.

Each case will be different. For tanks we can handle the industrial base issue through upgrades and foreign military sales. For submarines we will need a stretched-out buy. With airplanes we have enough procurement, and with the development programs for the F-22 and the new F/A-18 version, we can be confident that we will have suppliers out into the future.

Doing Business Differently

(Chart 11) Related to the need to increase procurement after '96 is the requirement to do business differently. In this budget there is not enough money in the outyears to increase the procurement accounts unless we cut our costs. That means acquisition reform is a real need and not just a good idea.

In addition, we need to reform our financial management. It is a mess, and it is costing us money we desperately need. Third, we need to continue to shed infrastructure. We urgently need the help of the Congress for all these activities.

All three efforts are designed to save money in the outyears, but none will save money immediately. There is no line in this budget for projected savings from acquisition reform. We will not credit those savings until we can precisely identify and verify them. To do the base closure process

correctly and quickly requires significant funds, and better financial management requires investment in new systems.

Taking care of the environment is in a slightly different category, but there are parallels. We must spend heavily to clean up past mistakes, and this is money which is an increasing drain on regular military accounts. But we are also trying to prevent the need for expenditures of this sort in the outyears. It is important to note that there is an additional \$5 billion in the Department of Energy budget for clean-up.

(Chart 12) The last theme I want to stress in this budget is defense reinvestment, totaling a little over \$3 billion. Much of this money is being put into dual use technology, where there is a clear benefit to Defense as well as a benefit to the commercial sector.

(Charts 13 & 14) The overall picture for Defense as a part of the national economy and budget shows the dramatic shift in resources from Defense to the non-defense side of the economy. Defense outlays are now down to 3.7 percent of GDP and heading toward 2.8 percent in '99. Defense outlays are already down to 17 percent of the Federal budget. That represents a significant peace dividend for the American people.

(Chart 15) This is the topline showing what we are planning to spend for America's defense.

A Strategic Investment Plan

(Chart 16) In sum, the President's FY 1995 defense budget represents a strategic investment plan. It is a blueprint for getting us to where we want to go. It is based on a common understanding of strategy and what is needed to carry out that strategy derived from the Bottom-Up Review. The Bottom-Up Review provides clear goals for ensuring America's defense. The budget connects our strategy to force structure and costs. I believe that it fulfills the President's pledge to sustain the "best-equipped, best-trained, and best-prepared fighting force on the face of the earth."

Let me now turn to several subjects that I believe might be of special interest to this committee.

The Bottom-Up Review

(Chart 17) First, some additional comments on the Bottom-Up Review. This study was truly a milestone for America's national security. The BUR solidified a consensus within DoD on the potential risks to America's security, the defense strategy needed to protect and advance our interests, and the military capabilities required to carry out our strategy to counter those risks. It also produced an affordable plan for the continuing

modernization of U.S. forces and for managing the industrial base to support a modern force. Finally, the Review achieved a consensus between DoD's civilian and military leaders on the most critical elements of a balanced program to achieve the needed U.S. security posture.

Perhaps the most important and controversial BUR conclusion was that the optimal U.S. force should be one sufficient to fight and win two nearly simultaneous major regional conflicts. This conclusion reflected a concern that if America were to be drawn into a war with one regional aggressor, another could be tempted to attack its neighbors--especially if it were convinced that the U.S. and its allies did not have enough military power to deal with more than one major conflict at a time. Moreover, sizing U.S. forces for more than one major regional conflict will provide a hedge against the possibility that a future adversary might one day mount a larger than expected threat. In sizing U.S. forces, we also committed ourselves to maintaining a strong overseas presence, which is essential to ensuring the vitality of our alliance relationships and maintaining stability in critical regions.

Defense Spending and Total Federal Outlays

(Chart 18) I recognize that this committee must consider defense spending in the larger context of the federal budget, and that there are enormous pressures to reduce the deficit and preserve domestic programs that directly affect our people. In that regard, this chart depicts the defense portion of this larger picture. It illustrates that focusing on Defense as the major cure for the deficit is out of proportion to its share of federal outlays. Let me hasten to add, however, that the primary reason that President Clinton and our nation's defense leaders oppose cuts beyond those planned is that it would carry excess risk to our future security.

(Chart 19) This chart shows that during the 1990s defense outlays are coming down dramatically. Defense is contributing to deficit reduction far in excess of its share of the federal budget. Unfortunately, increases in other segments of the budget dwarf our decreases--hence our nation's political leaders must continue their fully justified concentration on deficit reduction. My message here is simply that preserving America's future security must be as strong a concern.

The FYDP Funding Shortfall

(Chart 20) Finally I would like to explain the \$20 billion funding shortfall that has received quite a lot of attention.

The Bottom-Up Review was undertaken without a precise defense spending target in mind. When the BUR was completed, the Department found that the BUR program exceeded the

President's spending levels by a total of \$13 billion over the FYDP period. Secretary Aspin committed to finding the remaining \$13 billion during the normal review for the FY 1995 budget and FYDP. Reductions were made to many programs to achieve this goal. However, two developments complicated the budget review.

First, Congress provided a pay raise for military and civilian federal employees, whereas the Administration had proposed a pay freeze in FY 1994. The consequence of the pay raise was to increase funding requirements over the FYDP period by over \$11 billion. This was a real bill that had to be paid because the pay raise was mandated in law.

Secondly, the rate of inflation in future years was projected to be higher than was estimated at the time the FY 1994 budget was developed. Because of this change, it was estimated that DoD would need about \$20 billion more to pay for the BUR program over the FYDP period. Unlike legally mandated pay raises, these inflation estimates are likely to change several times during the year, and may well result in inflation cost growth below the \$20 billion over five years now estimated.

President Clinton reviewed these factors in December. At that time he reaffirmed his commitment to the BUR program. He also directed OMB to increase the overall DoD budget over the 5-year period by \$11.4 billion to provide for the effects of the pay raise over the FYDP period. However, the President opted not to budget for the multi-year inflation bill, which may or may not come due.

In order to implement the President's directives, the Department took two actions. It incorporated the full cost implications of the pay raise provided in FY 1994, and it repriced the BUR consistent with current economic estimates. These actions resulted in a defense program that exceeds the President's defense budget levels in the FY 1996-1999 period by about \$20 billion. Options to deal with this matter will be considered in developing the FY 1996-2001 FYDP--when updated inflation projections will be available. The President and the Department of Defense remain firm in their commitment to the BUR and the need to properly finance it.

Individual DoD programs and activities, through which the BUR is being implemented, all have been properly priced based on current estimates of inflation. DoD leaders are confident that planned forces and capabilities can be purchased for the monies projected in the FYDP. The Department used realistic projections for future costs, procurement schedules, likely savings, and other planning issues.

Chairman SASSER. One thing that comes to mind based on your charts there, just doing some back-of-the-envelope calculations, it appears to me that in 1990 there was about .5007 civilians in relation to active military personnel. In 1994, that ratio goes up to .5441. That is a 10-percent increase in over 4 years in the relationship between civilian employees and active military.

Why is that relationship going up? In other words, we used to talk a lot about teeth and tail, and it appears to me that the tail is not shrinking nearly as fast as the teeth are here.

Secretary PERRY. Senator Sasser, that is an astute point. It is a point I have made myself in reviewing these charts, and I simply say I don't accept this as the last word on the civilian decrease. I see no basis for the civilian personnel in the Defense Department going down at a rate less than the active military is going down, and I have already communicated that.

I should say there is a mechanical problem which is not easy to solve, but which can be solved, and that is that we can change the military end strength just by stating what it is going to be and the military conforms to it, assuming that the Congress supports that in the Appropriations Act.

We are not authorized to change civilian end strength that way. We have to deal with civilian end strength by reducing individual appropriations all along the way. It is a very different management task to change civilian end strength, but the bottom line is that we should have a decrease in civilian comparable to a decrease in military, and I think when you see the 1996 budget presented to you, you will see that reflected.

Chairman SASSER. Good.

Mr. Secretary, the Clinton administration has substantially scaled back the ballistic missile defense funding it inherited from its predecessor, the Bush administration. Over the period 1995 to 1999, the Bush administration had planned to spend nearly \$40 billion for Ballistic Missile Defense activities. The Clinton administration has pulled this total back from \$40 billion to about \$18 billion and reoriented the focus towards defense against theater ballistic missiles.

Now, it is precisely because of the Administration's progress in bringing this program down to earth over the long term that it causes me some consternation to see the request in the short term. The Administration is requesting about \$3.3 billion for ballistic missile defense activities this year. That is an increase of about \$400 million, or 15 percent, over last year's level.

I do not know of any other programs in the Department of Defense that are growing with the same magnitude as this ballistic missile program. Most all of the increase, to be frank about it, is in the program for theater missile defense.

Now, these programs are of much greater benefit to our allies than they are to us. If you draw a circle of the range of missiles that could be threatening from antagonists, not a one will reach the United States, at least not the Continental United States.

Now, at a time when a lot of domestic programs are being cut, why are we ramping up spending for theater missile defense, which really protects our allies from threats on the periphery of Western Europe and Asia? Most of these missiles that could be threatening

now, when you get outside of Russia or Ukraine, have very, very limited range, and they can only threaten perhaps portions of Southern Europe, portions of the Middle East. But they are no threat to the United States. Why are we upping our spending, when our European allies, who are more directly threatened, are doing virtually nothing about it or very, very little?

Secretary PERRY. A few comments on that, Senator Sasser. First is that this money for theater missile defense is intended to protect our forces in the field, not the Continental United States. As you pointed out, we do not see a threat at this time to the Continental United States, so it is only intended to protect our forces in the field, as, for example, when they were deployed in Desert Storm.

Second, though, your point about the interests of our allies is I think entirely correct, and Mr. Deutch has had extensive and intensive discussions, both with our allies in Japan and Korea on the one hand, and our allies in Europe, relative to joint development programs in this area, and we are vigorously pursuing the possibility of having such programs. That is not reflected in this budget, because we do not have any such agreements yet.

We also are working jointly with the Israelis on their ballistic missile defense program, which they call the Arrow, and exploring ways in which we may be able to get some cross-benefit in that program. But there is not much to show for that, and your point is correct on that.

Chairman SASSER. I am frankly concerned about it, because, according to a recent study by the Congressional Research Service, while the United States has spent in excess of \$32 billion on ballistic missile defense research, our allies have spent less than \$1 billion.

Now, what incentive is there really for our allies to increase spending on ballistic missile defense research, when the United States is continuing to pour money into it and continuing to further ballistic missile defense research. If I were the French or the Germans or the British or the Italians, or even the Israelis to a certain extent, I think I would be inclined to lay back and let the Americans do it, let them spend the money on the research, and then perhaps we could get in at the tail end and collaborate with them.

One other thing with regard to protecting our own forces abroad, those forces by and large are there to protect our allies. Certainly that was the original reason many of them were in Europe. That is why they are in Korea. I think the psychology is wrong here. If we continue to ramp up R&D spending on theater missile defense research, I do not anticipate we are going to get much collaboration or support from our allies, because the history has always been, as long as we will spend and do it, they will urge us on and hold our coat and let us do it, Mr. Secretary.

Secretary PERRY. I take your point, Senator Sasser, and I can assure you that we will pursue that vigorously.

Chairman SASSER. Thank you, sir.

Senator Domenici?

Senator DOMENICI. Mr. Chairman, I think I am going to yield to Senator Grassley. I will have to go to the floor at about 11:30, but if you are still on, I will run down there and come back. He has been patient, and he has some observations he wants to make.

Senator GRASSLEY. Mr. Secretary, I want to bring up the \$20 billion inflation problem that is addressed here, and I want to put it in some sort of historical perspective and ask your consideration. This, of course, is for the outyears, for your future year defense program.

I guess considering the historical perspective, with no accusations against your judgment when I look at the \$20 billion problem, it could be a \$50 billion problem or it could be a \$100 billion problem, because we have seen that happen in the past. But whether it is a \$20 or \$50 or \$100 billion problem, it does represent an over-programming problem, and that is a problem, as far as I am concerned, with the integrity of the defense budget.

Mr. Chairman, you and I have worked this problem together for a decade. Most of the other members of the committee have not been here that long, and so I would just add a little background.

In 1983, I was alerted to an internal DOD briefing that exposed this problem and its adverse consequences. Then-Secretary Weinberger refused me a briefing. We ended up hauling an obscure analyst by the name of Chuck Spinney before a joint hearing of this committee and the Armed Services Committee, with some high drama in the Senate Caucus Room. Of course, after that briefing, that analyst was not so obscure, because he ended up with his picture on the cover of Time Magazine.

The point of the briefing was this, and it is still true today: The over-programming game at the Department of Defense, which is as certain as death and taxes, hurts our national security. The game is like this: Costs are underestimated, while production buys and appropriations are overestimated, and then, of course, that leads to front-loading and to buy-ins which produce a procurement bow-wave. And the consequences of the bow-wave are inevitable. When the bills come due, the costs of everything go up, and the quantities go down. And the taxpayers suffer, and then I think our national security suffers as a result of it.

To put this in terms of something that my colleagues can understand, I often refer to this, and have several times before, as a blivet, which is 5 pounds of manure in a 4-pound sack. So I hope that you see an analogy, Mr. Secretary.

What we have got here is \$20 billion worth of manure that will not fit into the budget, and it may be much, much more. My colleagues understand that, because we have the same problem in the rest of the budget. We have to deal with it every year here in the Congress, and we deal with it with something called appropriation caps. And there are all kinds of games that you can play with it.

My colleagues also might understand the term from the Reagan years, when we referred to it as a "magic asterisk." I have these charts here where I want to show that with the President's budget submitted on February 7, we see a gaping hole right here where we had blanks for the outyear defense numbers, and that comes, of course, from Table 5.1 on page 69 of the historical tables, just as in this first chart I have here.

HISTORICAL TABLES

Table E.1 - BUDGET AUTHORITY BY FUNCTION AND SUBFUNCTION: 1975-1999 - Continued
(in billions of dollars)

	1982	1983	1984 estimate	1985 estimate	1986 estimate	1987 estimate	1988 estimate	1989 estimate
050 National Defense:								
051 Department of Defense - Military:								
Military Personnel.....	91,321	76,974	76,773	76,478	N/A	N/A	N/A	N/A
Operation and Maintenance.....	93,716	98,191	97,972	92,884	N/A	N/A	N/A	N/A
Procurement.....	92,862	92,799	44,484	43,274	N/A	N/A	N/A	N/A
Research, Development, Test, and Evaluation.....	91,833	97,764	94,782	96,535	N/A	N/A	N/A	N/A
Military Construction.....	8,384	6,982	6,982	6,548	N/A	N/A	N/A	N/A
Family Housing.....	3,736	3,841	3,801	3,207	N/A	N/A	N/A	N/A
Alcoholism.....					N/A	N/A	N/A	N/A
Other.....	-1,579	3,012	1,822	938	N/A	N/A	N/A	N/A
051 Subtotal, Department of Defense - Military	382,127	387,194	346,967	352,152	343,441	340,234	348,723	353,884
053 Atomic energy defense activities.....	11,980	12,059	10,508	10,588	10,971	10,887	11,017	11,188
054 Defense-related activities.....	864	1,822	914	914	918	931	948	962
Total, National defense.....	394,970	399,075	358,389	363,654	355,330	352,052	359,688	366,134

Source: Budget of the U.S. Government Historical Tables FY 1995

I have raised questions about this at a half dozen hearings, along with other Senators. So last week we were sent some numbers and that will be the second chart here. But notice the line that says "Future Adjustments" right here. I had speculated that the reason we got blanks in the first place is because the numbers did not add up and you would have to show a negative funding wedge or magic asterisk to make that add up. Then, lo and behold, we did get numbers last week and, sure enough, the numbers do not add up and, just as sure, we have the appearance again of a magic asterisk, Mr. Chairman.

DoD Budget Authority by Title (Current \$ Billions)

	FY95	FY96	FY97	FY98	FY99
Military Personnel	70.5	66.2	65.7	66.1	67.3
O&M	92.9	88.0	88.0	88.5	98.6
Procurement	43.3	48.4	49.8	57.1	60.1
RDT&E	36.2	34.8	32.1	30.9	30.2
MdCON	5.0	7.9	5.0	4.7	4.0
Family Housing	3.3	3.6	3.7	3.6	3.9
Future Adjustments	-	-6.4	-5.4	-5.0	-3.3
Funds and Other	0.9	0.9	1.4	0.8	0.2
TOTAL DoD	252.2	243.4	240.2	246.7	253.0

Source: Office of Management and Budget

I would like to say a word about the magic asterisk, because I think, from an historical perspective, it is something that we ought to think about as we consider the defense budget this year, because we have been through it on this committee before.

Last night, I had an opportunity to pull from my library a book that David Stockman wrote about the budget game in Washington during those years. He recounts the famous story of the magic asterisk, that tells about how this committee refused to let a budget go through back in 1981 that had a line called future savings in it. That was \$44 billion at that time, Mr. Chairman.

Howard Baker was the one who called it the magic asterisk. It was not for the defense budget, but at that time it was for the entire budget. Three of us on this side of the aisle voted against the budget, against a President of our own party, and the budget failed, at least at the committee level, at that particular time. That is because this committee, it seemed to me, would not allow a budget to go through that lacked integrity. We would not stake our vote on a promise to make some tough choices manana.

Senator Domenici, then chairman of the committee, said—and this is a quote from David Stockman: “The Budget Committee is not going to buy a pig in a poke.” The pig was the \$44 billion in budget savings, the poke was the to-be-proposed-in-the-future aspect of it.

My colleagues on this committee I think understand this, and I would suggest to them that this line here, “Future Adjustments,” in a sense makes the entire defense budget at least for those out-years kind of a pig in a poke. In this second chart, we see where you went from all blanks, Mr. Secretary, and that is in the first chart, to a page full of numbers with a negative funding wedge,

and that line is called the "Future Adjustments." The Stockman budget called it "Future Savings." Either way, it is kind of a magic asterisk, as I see it.

What you are saying, from my perspective, when you use these words, is that we are going to make decisions manana. In fact, that is exactly what I think you have said in your testimony. The President did not budget for this, and so you put in a negative plug and you say you will deal with this next year. I do not think we on this committee should buy that. At last we did not buy it in 1981 and we should not buy it now.

Mr. Secretary, I want to refer to a speech that you gave at the Association of Old Crows on October 12.

Chairman SASSER. The association of what?

Senator GRASSLEY. Old Crows. You spoke to them about the inaccuracy of the past future year defense programs and, of course, you promised to correct it. I have a copy of your speech here. You mentioned that,

We have a dramatic over-capacity in industry today which aggravates a problem that we are facing of consolidation.

I would like to suggest to you that this over-capacity continues to be fueled by over-programming in the future year defense program.

The General Accounting Office I hope will be out shortly with an independent assessment at my request of the real extent of the over-programming. I fear it is much, much greater than the \$20 billion. If it were only \$20 billion, which is less than 2 percent of a 5-year defense budget, I think a good manager like you could have resolved it, especially given the President's instructions. The fact that it is not resolved reinforces to me that the problem is much greater than \$20 billion.

At this point, I would invite from you whether or not you agree that the numbers do not add up and, second, could you guarantee us that the mismatch is only \$20 billion?

Secretary PERRY. The answer to the second question is no. Let me get to the first question.

Senator GRASSLEY. OK. Go to the first question. Thank you.

Secretary PERRY. Let me go back to the speech I gave about programming integrity and budget integrity, an important point. We have made every effort we know how to make to put together a budget that has integrity, and by that I mean that the programs that are in this budget have been costed as honestly as we know how to cost them.

Now, I want to draw a distinction between over-programming, which is the point you were making, Senator Grassley, for which you have I think correctly criticized previous budgets—I was on your side in some of those arguments during the 1980's on the over-programming budget—and a quite different problem, which is the fact that we have to make a 5-year budget estimate based on an estimate of what inflation will be 5 years from now, or 3 years from now, or 2 years from now.

We cannot do that, and that is why my answer to your second question was no. I have no way of estimating inflation 3 years from now or 5 years from now. Indeed, the so-called \$20 billion problem is precisely that problem. We put our programs together in the spring of 1993, and we made our best estimate of what it would

cost to do all of those programs. We translate that into dollars from 1995 through 1999, based on the then Congressional Budget Office estimate of what inflation would be for those years.

Shortly before we submitted the budget, the CBO made a different estimate of inflation for those 5 years. When we reflect that different estimate in, it comes out to \$20 billion higher for the same programs, \$20 billion higher in then-year dollars than the ones we had submitted.

So we were then confronted with exactly the same programs now having a budget shortfall of \$20 billion, because the mechanism by which we submit budgets to the Congress does not permit it to be in constant dollars. It is in then-year dollars and, therefore, you have to estimate inflation.

Since that time, CBO has made another estimate of inflation, and the recent figure is now \$11 billion, instead of \$20 billion. When we get to actually submitting the 1996 budget—this is not a problem of fiscal year 1995, the first problem occurs in fiscal year 1996—when we submit the fiscal year 1996 there will be a different estimate and we will have to somehow accommodate that. The problem may have gone away by then, if inflation estimates have gone down, or more likely the problem will be higher by then.

I submit that gives us an impossible problem of trying to budget. What we can do is make the best estimate we can of program costs. We cannot make independent estimates of inflation. We use the CBO estimates of inflation. Every time they change that estimate, we are going to get a different top line as a consequence of that.

If that system cannot be changed, then we have only one alternative when we get to fiscal year 1996. That is, in fiscal 1996, if this \$20 billion figure still exists and we are looking in fiscal year 1996 at a \$6.4 billion shortfall, then in fiscal year 1996 we either have to get an increase in top line to accommodate the inflation, much as the various entitlement programs have inflationary adjustments to them, or if that is not possible, then we have to cut programs that we were planning to do, at that stage.

There is a third alternative that is conceptual. The third alternative is that we could become more efficient in how we do our business, and that was the famous Weinberger estimated savings that would be included in the budget. I am in favor of becoming more efficient, and we are working to try to become more efficient. But I do not propose to put into our budget efficiencies that we have not been able to explicitly identify how we are going to get them.

So that is what I mean when I say we will give you an honest budget, but there is nothing that we can do for the fluctuations in this budget from quarter to quarter with inflation change estimates.

Senator GRASSLEY. Mr. Chairman, I do not have any more questions, and you have been good to me. But let me just say to you I think that there is a little bit more here than just an inflation problem, and I made this point before. I do not know why the Defense Department, as one department of government, should not be able to predict inflation for 5 years for budgetary purposes, when every other agency of government can and does in the budget, because we did not have these blanks in any other part of the budget.

The second point I would make is I think maybe the Chairman ought to consider that this committee might benefit from a Spiney-type briefing like we had a few years ago.

Chairman SASSER. Thank you, Senator Grassley.

Senator Dodd?

Senator DODD. Thank you very much, Mr. Chairman. Let me thank you, for holding these hearings today.

Let me begin by commending the Secretary. I think this is a most creative, imaginative, and thoughtful approach. Obviously, this is not an easy time. There is an assumption that many people believe, that because one threat has been eliminated—a threat that we have lived with for 5 decades—that we can now relax. We cannot, however, avoid the obvious new threats that have been posed as a result of the change in the bi-polar confrontation that absorbed us for so long.

Obviously, one need only pick up a morning newspaper to realize what potential dangers are out there. I think you have balanced well the obvious need for reducing expenditures, while at the same time taking into consideration these new threats. You have put together a rather creative approach, and I commend you for it. Obviously, looking at the readiness of our forces is critically important. As is our overseas presence, reduced as it is; the modernization of programs; the industrial base—which is a critical issue; a reduction of defense threats through expanded cooperation, counter-proliferation and enhanced peacekeeping capabilities. I think all are tremendously important and will contribute to a strong, but obviously leaner structure.

I would like to just focus on two questions, if I could, and I will ask them both and give you a chance to respond. I would like you also to respond to Senator Grassley's last point, because I think it is an important point. I respect your answer on inflation and the shortfall.

We can get some answers, we can fill in the gaps and they will provide some real numbers. But the fact of the matter is the economy has changed and the numbers change. You cannot control those numbers, and someone comes back and points an accusing finger at you 3 years later and says you did not have it right. Of course, you did not, but in your desire to satisfy those who wanted some very specific numbers, you try and meet those inquiries, and then are held accountable when they do not hold up—because they are based on facts that you cannot control.

So I respect your response to the question. Frankly, we need more of that honesty, in my view. It reflects the unknowns. In telling our constituencies and others, we cannot predict these things exactly.

But let me focus, if I can, on the modernization issue, because you are talking about a significant reduction. One of your charts indicates that the percent of GNP is shrinking to around 2.8 percent by the end of the decade. As you stated, those figures are the lowest since the 1950's and represent a fundamental change in our national spending priorities, a significant change.

I wonder if you could elaborate a bit further on how you plan to continue important modernization programs, while at the same time reducing the budget to that extent, realizing those moderniza-

tions are a critical element, in my view. Reducing the budget is necessary, we understand that. But the modernization in the face of those reductions has to go on. The only way, in my view, you can justify the kind of reductions you are talking about, is to maintain a proportional modernization of the very equipment that we are going to depend upon in the end of this decade or, probably more realistically, in the first part of the next century.

Let me mention specifically one area, and I use it as an example, and that is in the area of your rotary aircraft procurement. Now, we are going to cut it by \$600 million in this budget, and I understand that. The question obviously becomes whether or not we are going to be able to modernize or produce airframes later on, when you are making that kind of a reduction in a critically important area of technology for our country.

In that regard, I will ask the second question, and that has to do with your defense acquisition reform. Again, I am impressed by the fact that you are really focusing on this, because for too long the acquisition process strangled some of the very industries that we depend upon for our national defense, and it is extremely difficult for them to operate.

I think your point of getting away from defense industries, as you talked about, expanding that concept to incorporate the National security needs as part of the industrial base generally, is critically important. What will have to happen, if that is going to work, is reform in the acquisition process, if we are going to keep that private industrial sector willing to cooperate and work with the National security needs of the country.

I wonder if you might just spend a couple of minutes putting some more flesh on these issues.

Secretary PERRY. Yes; let me comment on several of the points you made. First of all, in the modernization program, in order for us to get back to an acceptable level of procurement and modernization of equipment, two things have to happen. First of all, we have to stop the decrease in the defense budget in the 1998-1999 period. In the budget which I showed you here, it did reflect that we are back to a flat, in real terms, defense budget in 1998-99.

Second, we have to gain the benefits already in 1996 and 1997, as well as 1998 and 1999, from some of the overhead and infrastructure reductions we are making, the base closings, the personnel reductions. The reason those do not come in until 1997, 1998 and 1999 is they have up-front costs associated with them. If we close a base, it costs us for the first few years. We will start to get the benefits of those in 1996, 1997 and 1998, and then we will start to see the money flowing over from those infrastructure accounts into modernization. That is going to be a very important benefit.

On the rotary aircraft, which is a particularly important part of our industrial base, I did not mention it specifically in my briefing. I did say that for tactical aircraft, we are not taking special measures, because we have sufficient programs within. That is true for tactical fighters, and it is also true for rotary aircraft, based on certain assumptions. I think 60 of the aircraft in that roughly 120 that are being procured in 1995 are helicopters.

So the problem in the helicopter base is in the latter part of the decade, not in the 1995-96 time period, and there we have to have

a combination of foreign military sales and domestic buying to sustain the base to get to the next generation helicopter, which is the Comanche. We are committed to sustaining that industrial base until we get to the Comanche. Whether or not we will be able to do that by the combination I described to you is not entirely clear at this point. But if it is not, if we do not get enough foreign military sales, then we will have to increase domestic buying to that, because it is crucial to sustain this base up to the point where we are into production on the Comanche helicopter.

The last point was on defense acquisition reform. The major changes we have to make to keep this whole industrial base available to us first of all is converting from military specifications to commercial specifications. As long as we require that everything we buy be built to a unique defense specification, that precludes an entire industry segment out there from selling to the Defense Department. And we do that not only in cases where it is obvious, like with fighter aircraft, but we do it with the components in fighter aircraft, like electronic chips that go into them. It is no longer necessary to do that, and it costs us money and it deprives us from a whole portion of industry.

We also do it in common supply items we buy. One of the famous horror stories in defense acquisition is the military specs for chocolate-chip cookies, specifying how many chocolate chips had to go in each cookie. It is not just the specification that is the problem, Senator Dodd. It is once you make that specification, then you have to set up a system for certifying that it has been met, somebody to go out and count the chocolate chips, and that is what creates this overhead structure. When we confront industry with those kinds of specifications, they do not have the provisions for making the certifications. Therefore, in too many cases they simply do not bid on our programs. We have to get rid of those military restrictions on procurement, and I think we will be able to do that in most cases. I think we will be able to do that with about 90 percent of them. That will make a big difference in and of itself.

Senator DODD. I appreciate that. Let me just mention one other point, if I can, Mr. Chairman.

Senator Dirk Kempthorne and I have tried to come up with some ideas on the foreign sales approach and limiting it just to NATO allies. I am very reluctant to see us expand foreign sales of military hardware to Third World countries.

I think this fits with Senator Sasser's point earlier about the acquisition of tactical missiles that are deployed in areas that benefit our allies, but who do not necessarily contribute to their defense at least in an immediate sense. One way we might offset a bit of that is to try to come up with a creative approach on how our NATO allies and a few others might be more forthcoming in terms of acquiring whatever defense articles they have through a process that would allow us to be more competitive in the selling to friends that we can trust.

That proposal—I think we have passed it—is down at the Defense Department. Over the years, we have been able to get some strong support for it. We tried it through the Export-Import Bank initially, and that ran into some indigenous hostility. I was able to

get one program through which worked very effectively, but obviously it was just for that one particular sale.

We ought to take a good look at that. I think you will find some strong support up here. If it is done properly and not seen as a way to expand to Third World and developing countries, but limited to those allies with whom we have a good relationship. I think you would get some strong support, assist in modernization, and offset some of the concerns that Senator Sasser has raised about the disproportionality in missile acquisition.

Secretary PERRY. That is a very good point and I think you make the proper distinction. We should be very hard-nosed about selling weapons to nations that we do not want to have those weapons.

Senator DODD. Absolutely.

Secretary PERRY. When we have decided with our allies if we are going to make sales available to them, it would seem to me we should be willing to be positive about assisting those sales, and what you are describing is totally compatible with that philosophy.

Senator DODD. Thank you very much, Mr. Secretary.

Secretary PERRY. Thank you.

Senator DODD. Thank you, Mr. Chairman.

Chairman SASSER. Thank you, Senator Dodd.

Senator Gregg?

Senator GREGG. Did you wish to proceed, Senator Domenici?

Senator DOMENICI. No, that is fine. I have a little time.

Senator GREGG. Pursuing this issue of procurement, let me go to a very specific concern that I have, which you may or may not be familiar with, Mr. Secretary, and that is the issue of the public/private shipyard question.

As you may or may not be aware, GAO has taken a look at the bid process between public and private yards and determined that the public yards are unduly prejudiced by the present allocation of overhead. Secretary Dalton has said he will review the GAO report, but has basically said it is not a definitive document.

I guess my question to you is are you familiar with this concern between the public and private yards and the real, I think, legitimate points that the public yards make, which is that if you are going to have a fair bidding process and get the best price for the Defense Department, the public yards should be able to participate on a level playing field with the private yards and not have a misallocation of overhead within the system, which makes it impossible for public yards to win these contracts?

Secretary PERRY. I am very familiar with the problem, not only with shipyards, but some of our depot maintenance, where we have a similar issue. I support the philosophical concept you describe, which is getting a level playing field, but I do recognize how difficult it is to do that.

Some people have advocated that we ought not even allow competition between public and private, because of the difficulty of determining that level playing field. We have a detailed study of that issue underway in the Defense Department today, which I expect to advise me on how to proceed on that problem in a few months. It is a very complex problem and I do not have a simple solution. I do recognize the importance of the problem and the complexity of the problem, and we are looking very hard at it.

Senator GREGG. Well, I know the delegations of Maine and New Hampshire would like to have a chance to sit down and talk with you about that.

Secretary PERRY. I can assure you that study will be done without any prejudice against public shipyards or, for that matter, the public maintenance facilities we have.

Senator GREGG. You raise an interesting issue, which is whether they should be allowed to compete at all, which gets to the core workload. Do you presume or expect that you will be defining the core workload as a division between the public and private yards in the near term? And will that definition occur before the next base closure round occurs?

Secretary PERRY. That is the fundamental question being considered by this study right now, which is whether you should define a core workload and give that to the public yards on a sole-source basis, rather than having them compete for it.

If, on the other hand, the conclusion is we ought to be competitive, then the burden is to find a level playing field which will allow fair competition to take place. Those are the two issues that we are working on.

Senator GREGG. Well, you can have a core workload and then you can have competition for—you know, the core workload was basically allocated to the public yard and the private yard.

Secretary PERRY. Yes; to the public yard.

Senator GREGG. And then you could have competition for anything that did not fall in the core workload, and then in that competition area we would like to see the playing field be level. I guess my question is what is your timeframe for making that definition in relationship to the base closure process.

Secretary PERRY. It will be quite a bit before the base closure decisions are made.

Senator GREGG. Is there a month timeframe you can give us?

Secretary PERRY. I would estimate this summer.

Senator GREGG. This summer. On a second issue, the Secretary of State has said that if there is a peace settlement in Bosnia, that it could take up to 25,000 American troops as part of the commitment, something which I do not happen to think is a great idea. On the budgeting side, how much is that going to cost us? Have you done any preliminary estimates of what it would cost to maintain that type of force or any other force activity within former Yugoslavia? And how are you planning to pay for that?

Secretary PERRY. First of all, we do not have an estimate yet of what force structure would really be required, because we do not know, and we cannot really do that until we know what sort of a peace agreement is reached and what functions are going to be necessary for the peacekeeping force. Therefore, we have not determined a force structure yet and we have not determined a cost that goes with it.

We could do generic cost estimates, and whatever the amount turns out to be, it will be substantial and it is not in our budget today. So we would propose as part of our consultation with the Congress on the peacekeeping forces to come in with an estimate of costs, and we would be requesting a supplemental appropriation for that purpose.

Senator GREGG. Well, the Secretary of State has used the figure of 25,000. Could you do a run-up on costs of maintaining a 25,000 peacekeeping force in former Yugoslavia for an extended period of time, say 6 months to a year?

Mr. HAMRE. Senator Gregg, there are a lot of uncertainties that go with this. One, of course, is what is the financing mechanism, is this to be an operation that is run through the U.N., or is it to be through NATO. There are different cost shares that go with each of these and that is a policy decision on how it is going to flow, and it would make a difference. We certainly could provide a unique estimate on hypothetical conditions of that, and we have a cost model to be able to do that. But there would be too many policy questions that would have to be offered to us to frame that debate in any meaningful way. We could work with you and your staff, however, to—

Senator GREGG. If I gave you the parameters which said 6 months to a year under either/or, NATO or U.N., 25,000 ground troops and whatever it takes to support them, which is the framework that I think the Secretary of State has mentioned, could you give us a number so we would know what is coming?

Mr. HAMRE. Sir, we have an estimating methodology that is agreed to within the department for forecasting purposes. It is dependent only exactly those kinds of assumptions. The important thing is they would be your assumptions as to what they would be—

Senator GREGG. I understand that.

Mr. HAMRE [continuing]. And would not be anything that would represent the department's commitment one way or the other until the actually policy is worked out. But subject to the Secretary's direction, I would be glad to work with you in any way.

Senator GREGG. I appreciate that. Thank you.

Chairman SASSER. Thank you, Senator Gregg.

Senator Conrad?

Senator CONRAD. Thank you, Mr. Chairman.

I thank the Secretary for being here, and I want to welcome you to the committee. I can say I have enjoyed the meetings that we have had and the several extended discussions that you and I have had with respect to budget matters for this fiscal year and beyond.

Mr. Secretary, you indicated in your opening remarks that the budget before us follows the bottom-up review. As near as I can tell from my analysis and my staff's analysis of the budget, that is true with respect to most parts of this budget, but it is not the case with respect to the bombers.

In fact, I have had this chart prepared which shows what I believe is a clear bomber gap between what was identified in the bottom-up review and what is provided for in this budget. The bottom-up review indicates that we need 184 bombers, B-52's, B-1's and B-2's. In this budget for fiscal 1995, there are 126 bombers which have been budgeted for. That is a difference of some 58 bombers.

General McPeak, the head of the Air Force, testified last week on the House side that he could not fight two major regional conflicts with the fiscal 1995 bomber force. In fact, we just got a clarification from the Air Force this morning with respect to the coding of bombers in four different categories, the combat coded, the train-

ing forces, the primary aircraft and the back-up aircraft, as well as the test aircraft. All of those codings add up to 126 bombers for fiscal 1995, but the numbers that are combat coded are only 87.

The bottom-up review says very clearly we have got to have 100 deployable, which translates into 182 to 184. So I am wondering how you make the assertion that this budget provides for what is called for in the bottom-up review with respect to bombers.

Secretary PERRY. It does not with respect to bombers, Senator Conrad. There were three items in the bottom-up review which were unfinished business when we finished the bottom-up review. The bombers was one, industrial base was the second, and the third I forget. But in each of those cases we concluded that during the next year we would have to do follow-on studies, and essentially these studies would be annexes to the bottom-up review.

One of those was the strategic force study, of which the bombers is a very crucial part. That study is underway now and it should be finished in a few months. When it is finished, it will become a part of the bottom-up review. Until that time, we cannot state that this budget or any budget conforms to the bottom-up review with respect to bombers.

So in this 1995 budget, we made the best estimate we could at the time we had to put the budget together as to what the bomber force would be. That estimate could be overturned by the strategic study in the next few months. If that happens, we will come back to the Congress and report that different finding to you.

Senator CONRAD. Let me say, first of all, I think that it is critical for this country's defenses that we overturn what is the budget numbers. I think it would be most unwise, and I think my colleagues would be very surprised to learn that we are talking about having 87 bombers combat coded in this budget. We deployed just in Desert Storm 75 B-52's.

I am told that for the SIOP that we would need at least 32 B-52's held in reserve for that purpose. I say to you that when you add it up generously, when you add up combat coded, which is 87, and you add up training forces, which are 20, you add up the back-up aircraft and the test aircraft, that adds up to 126 for fiscal 1995, and that does not meet the bottom-up review requirements. It is not close to meeting the bottom-up review requirements, according to the testimony of General McPeak.

The other day I had a detailed conversation with General Lowe, head of the Air Combat Command, and he says to me,

I can't fight two conflicts with the number of bombers that are provided for.

Mr. Secretary, might I ask if the strategic review indicates we need 32 B-52's for the hold-back for the SIOP, would that trigger a recommendation from you to add to the numbers, to restore the number of B-52's to the level of 74?

Secretary PERRY. If the results of the study which are coming out in a few months indicate the need for more bombers, which it very well might, then we would adjust our budget accordingly and we would recommend to the Congress accordingly.

Senator CONRAD. I appreciate that, and I think it is terribly important. By the way, we are not talking about a lot of money here. We are talking about \$150 million a year, approximately, to main-

tain another 27 B-52's. I might add parenthetically that we could fund 27 B-52's for 5 years for the same cost as building one B-2.

Secretary PERRY. Let me make one more point which I think is very important, on the issue that you are raising, and that is for these B-52's to be effective, truly effective in conventional warfare, we have to have improved munitions for them, and that is an important part of it. They are in the budget, but they are not in the budget for the complete number of volume.

Senator CONRAD. For the complete number.

Secretary PERRY. So we would have to look at the funding for improving the armament, as well as the funding to maintain the bombers.

Senator CONRAD. I understand. Let me say that I do not come here just with the suggestion of saying there is money that is not in this budget currently that ought to be here, without a suggestion of how we pay for it. I would direct the Secretary's attention to the Milstar Program.

I have now visited with top military officials and asked them each for their private recommendation with respect to Milstar. We are talking about a program that has a total life cost of \$27 billion. By the way, we just launched one and already we have got serious problems with it. The satellite suffers a power loss, as one person said, it is running on a spare tire. John Pike, Federation of American Scientists, said he found it curious that a satellite that was supposed to be able to endure World War III could not endure a month in space. He says they are running on a spare tire and the tire they just replaced turned out to be rotten.

I just say I think this committee and the relevant defense committees ought to take a very hard look at this Milstar Program. Again, I have visited with top defense officials who tell me it is a cold war dinosaur, it is way overbuilt, over-engineered for what we need for the future, as a result that costs far too much and delivers too little in terms of communications capability.

Mr. Secretary, maybe I could get your opinion on the record with respect to Milstar. Is it, as it is currently configured, something that we could not go back to the drawing board on and achieve significant savings?

Secretary PERRY. Since this is a complex issue, I will be happy to give you a detailed answer for the record, but I might say that already when we put the 1994 budget together and again when we put the 1995 budget together, we looked rather extensively at the Milstar Program thinking that it might be an area of considerable savings here.

We did not reach that conclusion. Maybe our judgments were wrong. We are certainly open to critique on that area. But it is not because we did not look at it pretty carefully. I will be happy to give you a few-page description of the rationale which led first of all to the decision to reconfigure the program, which was done in fiscal 1994, and, second, the decision to maintain it, rather than dropping it altogether.

[The following was subsequently supplied by Secretary Perry for the record:]

After a decade of development, the first Milstar communications satellite was successfully launched on February 7, 1994. As I promised during my testimony, let me

share with you the rationale for our current decision on the Milstar Program—rationale based upon extensive Departmental review.

The Milstar Satellite System is planned to provide operational forces—especially highly mobile tactical units—secure, survivable, flexible communications on a worldwide basis. The Milstar System operates in a previously unused portion of the radio spectrum—Extremely High Frequency (EHF). This attribute plus other design features, like advanced signal processing and crosslinks, provide unique mission capabilities.

The Milstar System supports a fundamental requirement to provide integrated connectivity to all theatre and tactical elements through a modernized, jam-resistant telecommunications network in support of operational forces. Milstar will satisfy many key requirements essential to the military operations of a power-projection force:

- Anti-jam: Milstar communications cannot be disrupted by the enemy
- Interoperability: Army, Navy, Air Force, and Marines—Milstar will enable immediate communications between the Services
- Mobility: Milstar terminals will move with front-line forces
- Covert Operations: Communicating via Milstar will not compromise the location of users to enemy listening systems
- Reachback: Milstar will enable communications out of theater without reliance on foreign-based ground relays vulnerable to destruction, sabotage, or host nation policy restrictions

The first two Milstar satellites will enable efficient synchronization of combat power and are not vulnerable to enemy efforts to deny United States forces this capability. As the number of tactical ground terminals expands; the first two satellites, coupled with additional satellites to form a complete constellation, will provide all the above capabilities.

With the addition of satellites #3 and beyond, Milstar will add capability to provide more data, faster to combat commanders. It will also enable the Army's Mobile Subscriber Equipment (MSE) to provide global communications to combat commanders on the move. No other planned or existing satellite system can provide the flexibility and assurance of uninterrupted communications available from Milstar.

While the Milstar Program originally focused on satisfying needs identified at its inception in the early 1980s—providing secure, survivable, flexible communications for both tactical and strategic users—the world situation changed dramatically and so did the scope and application of the Milstar Program. While the threat of protracted nuclear war has greatly reduced; the threat of regional conflicts has risen. During this time, the Milstar Program had been revised and restructured several times in conjunction with changes in force structure to meet the changing threat.

The Department restructured the Milstar Program extensively 3 years ago, at Congressional urging, to reduce costs and to account for change in the national security environment. Requirements for a classified payload were deleted. "Heroic" survivability features envisioned for the cold war environment were eliminated. The number of satellites and ground control elements were reduced commensurate with the threat and force structure reductions.

A higher capacity, Medium Data Rate or MDR payload was planned for a second generation Milstar II satellite which expanded its tactical utility. This MDR payload will greatly increase communications capability compared to the Low Rate (LDR) capability on the Milstar I satellite—use of both LDR and MDR will greatly enhance the utility of Milstar II satellites in a wide range of future potential scenarios. The restructured Milstar Program also reduced the number of strategic terminals and defined new mobile terminals for tactical uses. It reduced program life cycle costs by 25 percent, FYDP costs by 30 percent, and terminal costs by 35 percent.

The Department reviewed requirements and tailored the capabilities of the Milstar System to provide "flexible" and protected communications for mobile forces—redressing many of the deficiencies observed during Desert Storm when U.S. ground forces outran their communications support. These changes exploited many of the new technologies integrated into the EHF packages on the Navy's Ultra-High Frequency (UHF) Follow-On satellites. The Department also incorporated new technologies into terminal designs for mobile platforms, man portable and tactical applications. At the time, the restructure program gained the support of the four principal Congressional defense committees for reducing program costs and increasing its tactical orientation.

In 1992, the Joint Requirements Oversight Council (JROC) reviewed and approved a detailed set of operational requirements based on global military needs, with special emphasis on how Milstar would support a potential future South West Asian theater conflict. In October 1992, a Defense Acquisition Board (DAB) review

resulted in Departmental approval of the restructured Milstar Program, its acquisition strategy, and the development of the MDR payload.

Affordability was one of four principle criteria examined at the time—along with requirements, the acquisition strategy, and the program baseline. The Department considered Milstar Program costs against those of the other major defense acquisition programs, compared them to the DOD investment in the forces it supported, and assessed affordability relative to the overall DOD budget. Over the previous 2 years, the Department had examined over twenty different payload and architecture alternatives, and carefully assessed the risk associated with development of the MDR payload. Projected program costs were further reduced during this period by introducing plans for a smaller, more affordable Milstar polar adjunct to satisfy high latitude requirements, by reducing the number of Command Post Terminals, and by deferring a requirement to integrate Milstar terminals into a number of airborne platforms.

In 1993 during the fiscal year 1994 budget review, the Air Force identified a possible alternative approach for providing EHF communications. The concept included a distributed architecture of EHF LDR payloads initially located on existing satellites—Milstar I and the Defense Satellite Communications System (DSCS-III)—followed by a transition to EHF LDR payloads on Follow-On Early Warning System (FEWS) satellites and separate MDR communications satellites. While this approach offered some potential for cost savings, the Department found it would not satisfy the requirements of the Services and the Joint Staff.

In 1993, the Department further scrutinized MILSATCOM programs as part of the Bottom Up Review of military forces and major defense programs—consistent with a military strategy focused on theater conflict. The review evaluated numerous alternatives to Milstar while considering an updated threat estimate, operational requirements, cost-effectiveness tradeoffs, risk, and affordability. The review emphasized LDR and MDR capabilities for U.S. tactical forces. It focused specifically on providing lower cost alternatives to the baseline Milstar Program.

As part of this review, a select group of technical experts—known as the “Technical Support Group”, headed by Dr. Bob Everett with members from MITRE, Aerospace Corporation, MIT Lincoln Laboratories, and John Hopkins Applied Physics Laboratory—also reviewed MILSATCOM programs. The Technical Support Group recommended that the Department pursue a “cost-constrained” EHF system for protected connectivity by limiting the size of the communications payload so it would fit on a medium lift launch vehicle (MLV).

The “baseline” Milstar Program, examined in the Bottom Up Review, was the program which was reviewed by the DAB in October 1992. It included launch of two, nearly complete Milstar I satellites in fiscal year 1994 and fiscal year 1995, development and launch of nine Milstar satellites in fiscal year 1999–2011. The review ultimately examined four principal alternatives to this baseline—all with the objective of reducing costs. All four options would launch the first two Milstar I satellites. All four also included a transition to a lower weight, lower cost EHF satellite which would fit on an MLV, but delivered at different times. The options were:

- Option 1: Four Milstar II satellites, followed by the development and launch of an advanced EHF LDR/MDR satellite not later than fiscal year 2006
- Option 2: Cancel Milstar II and replace it with an MDR only EHF satellite in fiscal year 2000; replaced in turn by advanced EHF LDR/MDR satellite in fiscal year 2007
- Option 3: Cancel Milstar II and deploy an advanced EHF LDR/MDR satellite in fiscal year 2003
- Option 4: Similar to Option 3, but launch an advanced EHF LDR/MDR satellite in fiscal year 2000

Option 1 was selected because it best met military requirements and provided the most capability at the earliest date. All other options were higher risk and offered the potential cost savings only by deferring delivery of needed operational capability. Option 1 represented the best means of achieving that capability while reducing long-term costs. It is the strategy we are now implementing.

The Bottom Up Review confirmed, with independent technical assessments, that a processed EHF satellite system provides great promise for meeting requirements to provide protected connectivity to mobile forces. It validated the Milstar II approach as the lowest risk, near term solution and it identified the need to transition to a lower cost, lower weight EHF alternative.

Transition to an advanced EHF system will be technically challenging. To provide the same capability of a Milstar II satellite an advanced EHF satellite would need to reduce the payload weight from 4400 pounds to approximately 1500 pounds or less. Also, a new antenna suite must be developed to substitute for the 23 antennas

on Milstar II, but sized to fit on a smaller satellite. We are continuing to search for the best approach to this concept. We have begun an aggressive technology assessment program and have requested initial technology development efforts in the fiscal year 1995 budget to support a future decision on an advanced EHF satellite design.

In implementing the results of the Bottom Up Review, we ultimately saved about \$4 billion in life cycle costs and almost \$1 billion of program cost in the FYDP over the baseline program reviewed by the DAB in 1992. While the Bottom Up Review recommended transition to a smaller, advanced EHF satellite not later than fiscal year 2006—if it is possible to do so sooner, save more money, and continue providing essential military capability with acceptable risk—we will certainly recommend such a program to the Congress. The Department is committed to fielding the most cost-effective, affordable program.

Senator CONRAD. If I might, Mr. Chairman, let me give one other area of potential savings that goes to the hearing that we had the other day in this committee under the leadership of the Chairman, which I think was a very revealing hearing with respect to overhead and overruns and inappropriate billings to the Defense Department.

As you perhaps know, Mr. Secretary, the Chairman and I had requested a GAO study to look into this question, and the testimony from GAO was really quite revealing the other day. They found instance after instance where we are being billed, the taxpayers of this country are being billed for things that have got no relationship whatsoever to the defense of America.

There were six small contractors that were audited at the Chairman's and my request. Here are the kinds of things they found: Trips to Hawaii, \$135,000; Jamaica, over \$100,000, which is—you know, being down in Jamaica to have these business meetings apparently critical to the Nation's defense, according to these contractors—Bermuda, \$50,000; Mexico, \$49,000; Grand Cayman, \$46,000.

One of the most shocking things was they found one of these companies who had spent big money going to Hawaii. In this audit, they found that they have just gone back to Hawaii, spent a quarter of a million dollars to improve morale of their employees, stick the taxpayers with the bill, and then we are expected to accept that—\$230,000, I believe, and they had gone over and stayed in this resort over in Hawaii, a very attractive resort.

The Chairman and I were pleased to see that in the brochure for this resort, they indicated it was the best beach-front value on the big island, so at least they were going after value.

I say to you, these reviews have indicated there is a substantial amount of abuse in contracting, things that are being charged to us that should not be. They did an analysis based on the reviews they have done this far that suggested we may be talking about billions of dollars. In fact, they did a back-of-envelope analysis and comes up with, over a 3-year period, as much as \$18 billion.

I hope you will look into the reviews that we had requested from GAO and to pay special attention to the testimony that came out of that hearing, because I think there are substantial savings to be derived from things that are being sent to the taxpayers for payment that have nothing to do with the National defense, T-shirts to improve employee morale, trips, tickets to baseball games of \$8,000, the rental of a schooner at \$10,000, just one category after another.

I thank the Secretary, and I thank the Chairman.

Chairman SASSER. Thank you, Senator Conrad.

Senator Domenici?

Senator DOMENICI. Thank you very much, Mr. Chairman.

If I were the Secretary of Defense, I would ask that the Defense Department be able to audit the GAO. [Laughter.]

They have never been audited. They do not even have oversight. But you might find some interesting trips, Mr. Secretary. They used to have overseas offices. They have closed those now. It is one of the fastest growing branches of legislative government, and we find they do 10 studies occasionally on the same issue, depending upon who requests it. So I think you can survive their audit. You ought to look at those things that are mentioned. I think it would be helpful.

Secretary PERRY. We'll look at it, sir.

Senator DOMENICI. With reference to Mr. Spinney, I thought Senator Grassley mentioned you might want to have a hearing with him.

Chairman SASSER. He mentioned that, yes.

Senator DOMENICI. Well, I think we ought to at least give the Secretary equal billing with that fellow, if they come up here. He knows more about it and we can put them right there together. That would be my recommendation.

Mr. Secretary, let me ask with reference to the President's State of the Union Address, I quote:

This year, many people urged me to cut our defense spending further to pay for other programs. I said no, the budget I send to Congress draws the line against further defense cuts. It protects the readiness and quality of our forces. Ultimately, the best strategy is to do that. We must not cut defense further. I hope Congress, without regard to party, will support that position.

Mr. Secretary, is it your opinion that we should not cut defense below the levels you have recommended?

Secretary PERRY. Yes, it is, Senator Domenici.

Senator DOMENICI. If Congress cuts the defense budget below the levels you proposed, would you recommend that the President of the United States oppose those cuts?

Secretary PERRY. We would decide that on a case-by-case and a cut-by-cut basis, if it is entirely possible, yes.

Senator DOMENICI. I would hope in this case, that as these bills work their way through here, you know, this is a rather arcane process. This is not going to come right up and move over to the Defense Department and say they are cutting \$2 billion out of defense. It just sort of waffles its way through, and I would hope you would be watching it, so those of us who want to defend your budget are not confronted at the end of this appropriation process with trying to bail something out that we have not received support from you on.

Secretary PERRY. Mr. Hamre and I will watch it very carefully and we will be asking for help many times during the budget deliberations.

Senator DOMENICI. I appreciate that. Mr. Secretary, defense spending on activities that do not contribute to combat capability are creeping into the budget and growing in size. On your second to the last chart or the last one, you had \$5.7 billion for environmental cleanup.

Again, I repeat that you have a good environmental cleanup process going and you have had some very good experts doing it for the Defense Department. You are moving down a very positive trail, as I can see it. But you know we had the same number put into the Department of Energy budget and it turned out that after \$200 or \$300 million, it went to \$2 or \$3 billion, and then when we got around to actually estimating it—you might have heard it—it was \$300 billion over 20 years. Do you have estimates on where this \$5.7 billion in cleanup may be going?

Secretary PERRY. No, I do not, but I will try to get those for you. I do have a lot of confidence that we are not going to have anything like the kind of problems that they had in Energy, because of the nature of—

Senator DOMENICI. I think it is important that you try to get a projection that is reasonably accurate, because it will come right out of readiness eventually, because we will fund that, because, as you so aptly put it, for the most part, we almost have to.

So, how much of the operation and maintenance budget is devoted to activities that do not contribute to readiness? Would you give us that for the record?

Secretary PERRY. I can give you an estimate of that right now.

Senator DOMENICI. I would appreciate it.

Secretary PERRY. We fortunately have our able Comptroller right to my left here.

Mr. HAMRE. I had not thought that was going to be the question. Sir, we have in this budget about \$2.3 billion for environmental cleanup in the O&M account.

May I make a point to say that it is very difficult for us in the department, when Congress made an individual base commander criminally liable for pollution on his base. This has created fear in the department with installation commanders and is leading to a huge increase in the demand for cleanup activity and it is a very tough process for us to wrestle to the ground.

Now, over the 5 years I believe we have in total for all forms of environmental work, not only cleanup, but reclamation work, prevention work, as well as research and development, about \$50 billion. It is a large bill. I will get a precise number for you, Senator. But it is a large claimant and a growing claimant and one that we really need to work closely with you to put in perspective some of these cleanup costs. As you know, in a base closure, 20 percent of our base closure funds in this year's budget are for cleanup on those bases.

[The following was subsequently supplied by Secretary Perry for the record:]

The fiscal year 1995 President's budget contains \$5.7 billion for a number of environmental programs within the Department of Defense. \$2.2 billion is budgeted for cleanup of past contamination at our active bases and \$0.5 billion is budgeted for cleanup at Round I, II, and III closing bases. An additional \$2.2 billion is included for compliance with current environmental laws and regulations necessary for daily operations in carrying out our mission. \$0.1 billion is targeted for conservation of natural and cultural resources on lands entrusted to DOD and \$0.4 billion is planned for pollution prevention efforts that will reduce future contamination. An additional \$0.3 billion is budgeted for technology efforts that are projected to pay back the investment through cost savings and improved efficiencies in our environmental activities.

Based on our requirements, the Department of Defense anticipates environmental cleanup costs to remain fairly steady through fiscal year 2000. Cleanup costs beyond that point are anticipated to gradually decline in the years ahead. I have a high degree of confidence that we are not going to have anything like the kind of problems they had in the Department of Energy because of the different types of cleanups involved. Most of our cleanup requirements are petroleum, hazardous substances, and ordnance, rather than the radioactive and mixed waste of DOE sites.

Senator DOMENICI. Frankly, the Secretary hit it right, it is not necessarily this committee. He was closer to right in giving us big macro-oversights, but obviously this is not a small item, and so I ask about it. I also want to follow up by saying I would be concerned about what else besides environmental cleanup is in the O&M account that does not contribute to readiness. There must be some other things.

Mr. HAMRE. Sir, this tends to be where people will debate whether it contributes to—for example, we have locality pay that we are paying in fiscal year 1994, the tail for the locality pay is in fiscal year the 1995 budget. Does that contribute to readiness? Well, it directly contributes to the morale and well-being of the civilians that we pay inside the O&M accounts. We could choose not to do that or the government could choose, although you did give us the locality pay last year. It would be a very direct morale impact for our people. Whether that would affect readiness or not, we would have to on an installation and case-by-case basis.

Senator DOMENICI. I had occasion the other day, Mr. Secretary, in a closed session—and this is not closed information—to ask the Chairman of the Joint Chiefs of Staff about a summary of your 5-year budgeting for a number of accounts. I am just going to use 1 today for both you and your Budget Director.

Under the heading of O&M, you have \$92.9 billion in 1995. But if I follow it over 5 years, it actually comes down, it goes to \$88 billion, it goes to \$88 billion, \$85 billion, and then back up to \$90 billion. None reach as high as the \$92 billion, almost \$93 billion for 1995. Yet, we hear the Secretary say we are increasing readiness.

Mr. HAMRE. Yes, sir.

Senator DOMENICI. Can you tell us just generally what that is all about?

Mr. HAMRE. Yes, sir, if I may. And if I may specifically draw your attention to the fiscal year 1995 to 1996 change in O&M, because I think that is where you see the biggest reduction, it is a \$4.9 billion reduction from 1995 to 1996 in our O&M budget. Now, \$1.5 billion of that is not a cut because it reflects a reduction related to one-time costs in fiscal year 1995; \$1.0 billion making up for operating losses in the Defense Business Operations Fund, and \$500 million is for the overhaul of the Eisenhower. So \$1.5 billion of the \$4.9 billion is one time only, and taking it out of the budget, going to 1996, has no impact on readiness at all.

Second, there are three fundamental things that are finally producing savings in the O&M account in the out-years. Readiness activities in 1996 and the out-years are programmed at training levels budgeted for 1995. But we are finally generating savings in three areas: one, we are starting to see savings at the base operating level from the first three rounds of base closures, so this is the first year, in 1996, that we are seeing net savings occurring. Sec-

ond, and as you know, the Administration and Dr. Perry has a very rigorous proposal that I am wrestling with reducing civilian end strengths. We are going to average reductions of 4 percent and 4.4 percent over the next 2 years. So we are starting to see the effect of personnel reductions since salary costs are a significant share of the O&M account. And then we essentially achieve the bottom-up force structure reduction by 1995 and 1996. And so the force structure itself is coming down one last year. The \$4.9 billion reduction in O&M, is related to these initiatives.

Senator DOMENICI. Mr. Chairman, might I ask that that be presented to the committee in a document form?

Mr. HAMRE. I would be happy to do that, sir. I would be pleased to do that.

[The following was subsequently supplied for the record by Mr. Hamre:]

A further review of data suggests that between fiscal year 1995 and 1996, Department-wide O&M funding requirements could decrease a little over \$4.0 billion. Such a reduction would essentially be driven by several major factors, none of which should adversely affect readiness. First, the Department is expected to reduce civilian personnel levels, lowering fiscal year 1996 requirements by about \$1 billion. Second, the Department anticipates that BRAC related savings will increase to about \$1 billion in fiscal year 1996. Third, in fiscal year 1995, the Department incurs a one-time O&M expense of about \$1 billion to cover prior DBOF losses, and a \$500 million one-time expense to overhaul the nuclear aircraft carrier USS Eisenhower. These are nonrecurring actions which means that fiscal year 1996 funding does not correspondingly decrease, in real terms.

A word of caution is appropriate here. While the cited items reduce O&M requirements in the outyears, we have not yet conducted a detailed evaluation of fiscal year 1996 budgetary requirements. This will be done in the budget review this fall. It is possible that other valid requirements will be identified which offset the cited reductions.

Senator DOMENICI. I have two questions that have to do with this afternoon's testimony, and I am just going to submit them for your answer. One is to seek your advice as to what an \$80 billion reduction in defense might do as compared with what John Steinbrenner, someone whom you know quite well, I think, suggests we might do, and the other has to do with suggestions that we change the roles and missions of the services and how much that might save. So I am just going to submit them, and if you will answer them, I would appreciate it.

Mr. Secretary, I have another question. On one of those diagrams, you suggest that one of the new functions of the Department of Defense is the defense conversion TRP Program within ARPA. Mr. Secretary, I truly urge that you keep a very close look at that program. Any such program is fraught with danger in that it is very hard to truly affect defense conversion with grants and trying to use dual use technology.

The program is getting somewhat bigger. You ought to hope that the economy continues to grow at 2.7 to 3 percent for the next 6 or 7 years because then you can claim credit for the TRP Program, which will have little or nothing to do with putting people in jobs but, rather, the economy will have everything to do with it.

I think it is fraught with political potential, who gets the grants, who gets the money, so they can do the defense conversion.

Now, I have been a big advocate of defense conversion of technology, and you know that. But I am very concerned when we start

doing it outside of institutions that exist and do it in an ad hoc way, depending upon what people suggest will work.

I truly believe you do not want to see this money thrown away. There will be sensational projects offered. I hope you have somebody watching it very carefully in terms of its practicalness as compared with just spending money.

Secretary PERRY. I take your comments very seriously, Senator Domenici. I believe we have structured this program in a way that we have provided those safeguards to it. But we are always open to review and criticism.

Senator DOMENICI. My last one has to do with a program that your predecessor announced that I congratulate him for and urge that you continue on, and that is to make America's counterproliferation initiative the equivalent of what our integrated program was to maintain our nuclear superiority. I think we maintain superiority by charging the very brightest people in America with seeing that we never were beat on nuclear, in terms of the military, and that we were always on the cutting edge.

I think the next issue of that type is the proliferation of weapons of mass destruction. I believe bio and chemical proliferation is for the world what nuclear bombs were. And it is much easier to detect nuclear devices than these other two, but the latter two are more dangerous to humankind and are much more available to be used in blackmail and all kinds of things. So I hope that you insist that that program be integrated and that the military be right there with the specialists who develop the technology and with the Central Intelligence Agency and their needs so that we are putting the scientists to work on things you really need.

Secretary PERRY. I share your views on that, Senator.

Senator DOMENICI. Thank you very much.

Chairman SASSER. Thank you, Senator Domenici.

We will turn now to Senator Boxer. I am advised the Secretary is under a time constraint. He is supposed to be at the White House at 12:15, and obviously that is not going to be possible.

Secretary PERRY. I am sorry. 12:30, sir. I need to leave here at 12:15.

Chairman SASSER. Well, we will do our best.

Senator Boxer?

Senator BOXER. Thank you very much, Mr. Chairman. Thank you very much, Mr. Secretary. I just want to say publicly thank you for taking the job.

Secretary PERRY. Thank you.

Senator BOXER. Now I will stop my tough questioning.

Mr. Secretary, you yourself have said the cold war is over, and you are going through the budget to make sure there is no relics of the cold war. But as a member of the Budget Committee, I think we need to step back and take kind of a deep breath and a big look at what we are doing. And as I do that with a little help from people who are more expert than I, I have found out that we are going to be spending as much on defense as the rest of the world combined.

I also find that if you back out our allies' spending, we are spending twice as much as the rest of the world. So for those of my colleagues who are expressing their grave concern, let me ask you

this: Do you, first of all, agree with that analysis that I got out of the New York Times? And, second, are you worried about this level that you are putting forward for this committee? Are you concerned that we are not spending enough?

Secretary PERRY. I cannot comment specifically on those numbers, Senator Boxer. I do not have in my head what the other countries are spending. We certainly spend more than any other country or any combination of countries that I am aware of for defense. We have a defense establishment which is, without question, the best in the world, the most effective fighting force in the world as a result of that.

We are bringing the budget down to about a 40 percent real decrease since its peak in the mid-1980's because the threat has changed, because we can reduce our force structure. I think that is a safe reduction, and I have supported that and sponsored it. And we submit this budget with those kinds of reductions in the belief that it will provide an adequate defense for the United States.

The one part of this budget which I am most concerned about and which I have testified to several times is the cut in the modernization of the procurement account is really dramatic. We have reduced 70 percent from the spending we were doing just 6 or 7 years ago. And we can rationalize that, I believe, in terms of the equipment coming into our force structure. We are taking a risk in losing our industrial base.

I have taken several steps in this program to try to counter that problem, but I think that is the most dangerous part of this budget—the possibility that we will not have an adequate defense industrial base by the end of the decade.

Senator BOXER. Well, let me say in that regard I think the ARPA Program is a great program. I disagree with Senator Domenici. I think when we are looking at our industrial base and how we can keep these dual use technologies—because, Mr. Secretary, if we find a technology that works in the military and it can be adapted to civilian and you keep that industrial base going, Mr. Chairman, because you have found new ways to use it, such as, I might say, the Stealth bus that they are building in Los Angeles, where they are using the Stealth materials. They are using those materials to retrofit bridges.

We are finding some incredible successes in this, and I would also say to my colleague—who is not there—that because of the 50 percent match, we are not giving away anything here. We are forcing the private sector and the community to put up hard dollars and make hard contributions. So I think one way to keep that industrial base going and yet not become so uncompetitive because all we are doing is developing products to fight in a war when hopefully we are not going to have to fight in a major war, we can keep it going.

Also, because of your time limitations, if I could just make a few more comments, and then if Secretary Perry can respond, either here or in writing, I would appreciate it, Mr. Chairman.

Let me just say that I found the attack on the GAO to be somewhat bizarre. If someone wants to audit the GAO, fine, I will join in. But to discredit an audit that shows that taxpayer dollars are

being thrown out the window or, more accurately, into the ocean, Hawaii or wherever, to discredit that because you do not like the message is ridiculous. Excuse me for saying that. This is how I feel. We have to say, yes, there are some contractors out there who do not treat the tax dollars seriously. There are others who do who are models.

And, Mr. Secretary, I know you, and I know you get appalled at this. You yourself said you are worried. You can support this budget, but it is on the edge of what you think it should be. And I know and I am confident that you are going to move against these abuses. And I hope you will so state because every dollar we can save that we are not spending on what I consider to be false expenses or, shall we say, unallowable costs, which is the phrase I used to know when I was really into these procurement issues, that is money that can go into deficit reduction.

Mr. Chairman, I have had the pleasure of speaking to the Secretary about many of the issues I am concerned about. So rather than take a lot of his time, I will conclude in this way:

As I look over the Star Wars Program—and I still call it Star Wars; I know you have made great strides to break that program down into various aspects—I still have a great many questions about one of the aspects of the program, Mr. Chairman, which is not the theater missile defense but the National Missile Defense Program. It seems to me we are back where we started. We are putting \$1.2 billion into a program that, as far as I can tell, after having the chance at the Joint Economic Committee to hear from the CIA and having the CIA say unequivocally, out in the open—this is about a year ago—there can be no more threat from the Soviet Union or a group of nations in any way that was like the threat we faced.

Yes, there are other threats, and, Mr. Secretary, I know you are getting us ready for those other threats. But I must tell you, as I look at that part of the program, it gives me great concern, and I hope that either in this committee or further down the line, we can save some dollars, because there are other things we need to do in this country now that the end of the cold war has come.

Last, in terms of environmental cleanup at bases, please, if there is anything I can do to help you with that liability problem, if we do not clean up those bases, we are going to have ghost towns. We are going to hurt our country. And as the President has said, we cannot divorce, if you will, our economic security from our national security. We cannot afford to have these bases sitting there unattended.

Thank you very much, Mr. Chairman. I look forward to working with you on these issues. Thank you, Mr. Secretary.

The CHAIRMAN. Thank you, Senator Boxer.
Senator Brown?

Senator BROWN. Thank you, Mr. Chairman.

Mr. Secretary, it is a great pleasure to have you here. You have many admirers. You do not have an easy job. There are a great many of us who deeply appreciate someone of your intellect and your ability being willing to take this job. I think it remains to be seen whether or not it was your friends that got you into this.
[Laughter.]

Secretary PERRY. Thank you, Senator Brown.

Senator BROWN. The Army specifically strikes me as something of a challenge under the current strategy, as I understand it. We are committed to have forces able to respond to two major reasonable conflicts simultaneously.

How many divisions, Army divisions, are you looking at to be able to respond to regional conflicts simultaneously under that bottom-up review?

Secretary PERRY. The total number of divisions in the Army on the bottom-up review would be 10. We now have 12 Army divisions. We will over the next few years be going down to a total of 10.

Senator BROWN. And how will that break down between—

Secretary PERRY. That is not counting reserves.

Senator BROWN. So the reserves would be in addition to that.

Secretary PERRY. The reserves will be in addition to that. That is correct.

Senator BROWN. Do you plan additional cuts in reserve forces as well?

Secretary PERRY. There are some cuts in reserves as well; not as deep as the cut in the active duty. But, more importantly, in the reserves we are taking 15, I believe it is, brigades and figuring them in a ready state so that they will be better able to participate in the major regional conflicts. So a major change that is incorporated in this program is improving the readiness of 15 of those brigades in the Army Reserves.

Senator BROWN. How will the breakdown between heavy divisions and light divisions change?

Secretary PERRY. I do not have that in my head, Senator Brown, but I will be happy to get it for you for the record.

Senator BROWN. I appreciate that.

[The following was subsequently supplied for the record by Secretary Perry:]

That is a timely question and we have been aggressively pursuing the answer. Faced with an uncertain future and declining resources change is inevitable. Heavy divisions are extremely expensive and light divisions, designed for low intensity conflict require extensive augmentation for use in the type of regional conflict we envision. The Army is exploring its future requirements through extensive analysis including General Sullivan's Louisiana Maneuvers and Army Battle Labs. The products of this process will help us determine the mix of Guard, as well as Active Divisions, but until they are completed I cannot give you a better answer.

Senator BROWN. I know you have seen a lot with your current task, which is a tough one, the speculation that the Army and perhaps our other forces are beginning to shortchange the readiness accounts. The July 1993 publication "Inside The Pentagon" estimated that less than 90 percent of the Marine Corps equipment is ready to go to war—probably a low for the first time in 10 years—that there is a backlog in maintenance categories that has gone from literally 0 up to 160 million in just the last 2 years.

If you would, share with us your thoughts as to whether the article is accurate and how you view the problem with readiness.

Secretary PERRY. I think that article describes some of the problems that exist today in readiness; in particular, it highlights the backlog in depot maintenance, which is something we can measure quite accurately on a month-to-month basis.

In the 1995 budget, we have responded to that in several ways, but first of all by an overall increase in the O&M account of about 6 percent in the face of a 7 percent decrease in force structure. But more specifically we have increased the depot maintenance funding 20 percent because of the backlog which we have in the depots today, specifically to try to correct that problem.

More generally, Senator Brown, the way we have dealt with this problem is that when we requested the Services to prepare the 1995 budget, we stated in the guidance to them that they should make readiness their first priority, and we do see that reflected in the funds which they allocate to readiness in this 1995 budget. So I think there will be a significant turnaround on some of these issues where we are seeing problem areas right now.

Senator BROWN. It is at least my understanding that some of the peacekeeping funds and other environmental cleanup funds are coming out of the O&M account.

Secretary PERRY. Well, the peacekeeping funds come out of the O&M account. Fortunately, the Congress authorized a supplemental appropriation for us of \$1.2 billion, which caught us up with what otherwise would have been a very substantial readiness hit to all three of the Services. So that supplemental appropriations was a lifesaver relative to readiness.

Senator BROWN. Would the reduction, the drawing of peacekeeping funds out of this account change the picture? In other words, after you subtract the peacekeeping money, would you be looking at less money for O&M?

Secretary PERRY. Well, it is part of the O&M expenditures that is not otherwise available for, say, training or exercises. You can argue that there is a certain amount of training and exercise value in the peacekeeping operations in and of themselves, but the Services and I do not see it that way. We see that training and exercising are very specialized functions. And so they do tend to detract from readiness unless we can supplement those expenses with appropriations to get us back to normal again.

Senator BROWN. I would appreciate it if you can supply for the record an analysis of the O&M account, adjusting for the changes in peacekeeping funds. I realize that involves some calculations, but I think it would be helpful in understanding.

Secretary PERRY. We have the figures on how much of the 1993 budget, say, went to peacekeeping, how much of that was covered in supplemental appropriations, and the net then, you can reasonably believe, is a decrement to readiness.

Senator BROWN. I see the light is on. I simply would ask you to draw your attention to an area. You have hired a very outstanding scientist from Berkeley. I did not really know that you Stanford fellows went across the bay. But Dr. Smith is faced with the challenge of trying to deal with our chemical weapons and their neutralization and disposal.

I have been in contact with him because we have a base that has stored those munitions in Colorado.

Secretary PERRY. Yes.

Senator BROWN. Awfully impressive person.

Secretary PERRY. I have a lot of confidence in Dr. Smith.

Senator BROWN. I did not know if this was simply revenge against Berkeley or not that you are hiring him.

I wanted to draw your attention to one aspect of it. He faces a very difficult challenge because there are some restrictions or difficulties in transporting those chemical weapons to sites where they would be incinerated. The Congress further restricted your ability to transport them—or study, I should more precisely say, to study the transport. One alternative, though, that I believe has some merit is the potential of transporting neutralized chemical weapons, so that instead of building eight new incinerators that could cost up to \$1 billion each, that we would use our existing incinerators at both by either Johnson Atoll or Utah, Tooele, Utah, and that would be transported to them will not be chemical weapons, active chemical weapons, but what would be transported to them would be neutralized weapons.

The neutralization of it is largely a function that has to be done, anyway, and so the transportation would be, of course, far safer because you would not be dealing with an active agent. But you would have a chance of saving a dramatic amount of money in terms of not building eight duplicate incinerators. That, I believe, is authorized to be studied, and it strikes me it has some potential that I hope you all will examine.

Secretary PERRY. We will look into that. That is an interesting idea, Senator Brown.

Senator BROWN. Thank you.

Mr. Chairman, I simply wanted to add for the record for Senator Domenici, if you would allow me, in the questions over GAO funding, I think his observation was that the increase requested for GAO, \$26 million, is greater than the entire total budget of the CBO. And I think Senator Domenici's concern was over the size of the increase of GAO, which does seem, at least to this Senator, to be somewhat dramatic.

Chairman SASSER. Thank you.

Mr. Secretary, thank you very much for appearing here this morning. I am sorry we could not get you out at 12:15.

Secretary PERRY. Thank you, Mr. Chairman.

Chairman SASSER. We have done our best, and I also want to express my gratitude to you for taking this job as Secretary of Defense. It is an interesting turn of events when we have to express gratitude to dedicated public servants for taking these very, very important and crucial jobs for the country. I think that says something about the atmosphere in which we all have to work, and it says something that I think does not bode well for the country. But we are, indeed, grateful that a man of your caliber and character and qualifications would assume this job as Secretary of Defense.

The committee stands in adjournment.

Secretary PERRY. Thank you, Mr. Chairman.

[Whereupon, at 12:24 p.m., the committee was adjourned.]

WRITTEN QUESTIONS FROM SENATOR CONRAD TO SECRETARY PERRY AND THE RESPONSES

Question. How will the results of the Nuclear Posture Review (NPR) be integrated into the proposed bomber force structure? Will bombers identified by the Nuclear Posture Review be added to the 40 B-52s already budgeted? (For example, if the

NPR identifies a need for 40 B-52 bombers for nuclear missions, will DOD request 40 additional B-52s?)

Answer. The Nuclear Posture Review is examining all aspects of U.S. nuclear force posture and force structure. The results of the NPR will include recommendations on the number of heavy bombers that the United States should retain in its future force. All U.S. heavy bombers, including those currently funded in the active bomber force, are capable of carrying both nuclear and conventional weapons. The number of heavy bombers recommended by the NPR *would not* be an add-on to the number of bombers already in the total concept force, including those now in the attrition reserve. The B-52Hs and B-2s already in the force would count against the total recommended by the NPR.

Question. Under Department of Defense planning, will any nuclear-capable B-52 bombers be held in reserve for a nuclear deterrent mission, or will all B-52s be utilized in a dual role?

Answer. All B-52H bombers and all crews who fly B-52H bombers are capable of delivering nuclear and conventional weapons. The Department of Defense has not designated any B-52H bombers as a nuclear-only "reserve" force. Nevertheless, if B-52Hs are needed during an MRC, some number of aircraft and crews could be withheld from the conventional conflict so that they would be available to maintain a nuclear deterrent posture, if necessary.

Question. If no bombers are intended to be held in nuclear reserve, doesn't this reduce the credibility of the U.S. nuclear deterrent? In addition, if B-52s must be recalled from a conventional conflict to go on nuclear alert, wouldn't this cause major problems in the conventional theater?

Answer. Because all U.S. B-52Hs are dual-capable, *all* are a part of the U.S. nuclear deterrent force. The fact that they can also deliver conventional weapons if called upon in an MRC does not detract from their deterrent role or reduce the credibility of the U.S. nuclear deterrent. These aircraft have always been capable of delivering both nuclear and conventional weapons; they have been used in conventional conflicts in the past (e.g. Desert Storm) without raising any questions about the credibility of the U.S. nuclear deterrent. The primary difference between the future and past will be the number of bombers we will have available to perform these dual missions. The changing international security environment and budget pressures have led to a reduction in the size of the B-52H fleet. As a result, bomber resources could be strained if a crisis occurred that required B-52s to stand nuclear alert during an MRC. Under such circumstances, judgments about whether to withdraw bombers from an MRC would likely be based on two factors: the ability to use other aircraft to accomplish similar missions in the MRC and the ability to maintain a credible nuclear deterrent with fewer bombers as a part of the nuclear deterrent force.

Question. Does the Department of Defense plan to keep significant numbers of B-52s and B-1s "attrition reserve" beyond fiscal year 1995?

Answer. Bombers that are being held in "attrition reserve" have been funded in that status through fiscal year 1995. The Department of Defense has not yet made any decisions about the future of those aircraft beyond fiscal year 1995. Recommendations of the Nuclear Posture Review will be taken into consideration when such decisions are made.

WRITTEN QUESTIONS FROM SENATOR MURRAY TO SECRETARY PERRY AND THE RESPONSES

Question. Mr. Secretary, I am aware of the Department's proposed plan for the C-17 and I support the C-17 program. However, I am also aware that there is currently a shortfall in airlift. There was a *Wall Street Journal* article to that effect last week and congressional testimony as well. Therefore, I do not understand why the Department does not begin acquiring Non-Developmental Airlift (NDAA) right away to satisfy the current shortfall, and to supplement the final number of C-17 aircraft which may be procured. I do not understand why the Department intends to wait until the C-17 decision in late 1995 before it begins acquiring NDAA. Would you please comment?

Answer. The Department has initiated an NDAA acquisition effort. However, there are several reasons why we have elected to wait until the 1995 C-17 Defense Acquisition Board (DAB) to make a decision regarding NDAA.

We need an aircraft like the C-17. Thus the Department of Defense entered into a comprehensive settlement with McDonnell Douglas on the C-17 program over the next 2 years. If the C-17 does not meet expectations, an alternative must be immediately available. To that end, we have started a streamlined acquisition process

that will lead to an integrated decision on airlift force structure at the C-17 Milestone III in November 1995.

A decision now would lack essential pieces of information necessary to define the number and type of NDAA. There is considerable risk in making a hasty decision on the NDAA before the airlift requirement is clearly defined by the Mobility Requirement Study/Bottom-Up Review (MRS/BURU) and before the C-17 Milestone III decision is known. This is because the decision depends on the requirement and in part on the eventual C-17 inventory, in addition to the status and final disposition of the C-141 fleet. Further, we do not know today the extent of the modifications that may be needed to make a commercial derivative aircraft responsive to military needs.

Finally, at the C-17 Milestone III decision point, we will better understand the capability of the C-17. The results of the flight test program and the reliability, maintainability and availability evaluation will be available along with an assessment of the contractor's performance after the 2 year probationary period. The number of C-17s procured will directly impact both the type and quality of NDAA required. These points argue very strongly for making the airlift force structure decision early in fiscal year 1996.

Question. DOD has proposed eliminating or downsizing several Army Reserve units in the State of Iowa. It is my understanding that some of their duties will be taken over by reserve units and National Guard units in other States.

Please provide me copies of all economic analysis and cost-benefit analysis used to justify these decisions. In addition, please provide an estimate of the environmental costs of the decisions to eliminate or downsize Army Reserve units in Iowa.

Answer. The 410th Infantry Battalion, headquartered in Iowa City, IA, the 3d Battalion, 14th Field Artillery, headquartered in Sioux City, IA and their augmentation cells are being inactivated as a result of the inactivation of the 6th Infantry Division in fiscal year 1994. Both organizations were part of the 205th Infantry Brigade which was a round out unit for the 6th ID. Four other Iowa Army Reserve units (103d Headquarters Headquarters Company COSCOM Augmentation, 366th Finance Support, 4th Target Acquisition Detachment, and the 404th Corps Area Company) are being inactivated because their structure is obsolete and there is no requirement for them in the warfight. The 20th Procurement Detachment is being restructured with its higher headquarters in St. Paul, MN. An economic analysis and cost-benefit analysis are not normally conducted regarding elimination and downsizing of Army Reserve units when it is part of a force reduction. No facilities have been identified for closure. An environment cost analysis is not routinely conducted in this case.

The 989th Detachment, Air Ambulance in Ft. Des Moines, IA is the only unit in Iowa migrating to the National Guard as a result of the offsite agreement. GAO is currently conducting an audit regarding the Reserve Component restructuring. The results should provide answers to questions pertaining to this unit.

Question. The President's Defense Budget includes \$300 million for peacekeeping. What is your view of the Pentagon's role in peacekeeping, and what are the longterm budget implications?

Answer. The Department of Defense strongly supports the Administration's policy that the United States must be willing to act to preserve peace and stability when such action advances or protects our interests. The primary mission of our armed services is to be a trained and ready force than can fight and win our Nation's wars. Nonetheless, the Department of Defense also has a role in supporting efforts to conduct effective multilateral peace operations and, when it is in our interest, to be prepared to participate directly in these operations.

As you know, under the new peace operations policy, commonly referred to as "shared responsibility", DOD will have lead management and funding responsibility for UN Chapter VI peacekeeping operations in which U.S. combat forces are involved, and all UN Chapter VII peace enforcement operations. The State Department will have responsibility for Chapter VI operations which do not involve U.S. combat units. This approach seeks to apply the traditional delineation of responsibility between the State and Defense Departments to peace operations, dividing management and funding responsibilities on the basis of whether the operation involves U.S. troops or likely military engagement.

Under "shared responsibility", the \$300 million you mentioned in your question will be used to pay DOD's portion of our UN assessment for peacekeeping in fiscal year 1995. In the out-year, the Department of Defense will budget for UN peacekeeping assessments as we have done in our fiscal year 1995 budget request. We anticipate as well that our support of, or participate in, peacekeeping operations will result in additional costs, and that we will seek Congressional support for the use of Supplemental Appropriations to cover the incremental costs of contingency oper-

ations. At present, this is the best financing method for providing an element of protection for the readiness funding appropriated by Congress in the operations and maintenance accounts. Congressional support of the fiscal year 1994 Emergency Supplemental was extremely important in establishing this funding method, and we will continue to use this as our precedent.

Question. Mr. Secretary, from your perspective, what is the risk associated with a comprehensive test ban with respect to our nuclear weapons stockpile?

Answer. The United States will need to ensure that our nuclear deterrent remains unquestioned under a comprehensive test ban. Since we will not carry out any nuclear weapon test explosions, we will need to explore other means of maintaining confidence in the safety, reliability, and performance of our nuclear weapons. To this end, the Department of Energy is pursuing a stockpile stewardship program which includes stockpile surveillance; experimental and research, development and engineering programs; and maintenance of a production capability to support these efforts.

Question. How does Defense Department define Counterproliferation, and what exactly would be included here?

Answer. The Defense Counterproliferation Initiative (DCI) has two fundamental goals:

- To strengthen DOD's contribution to government-wide efforts to prevent the acquisition of nuclear, chemical, and biological weapons, and their means of delivery in the first place or reverse it diplomatically where it has occurred. DOD contributes through marshaling its unique technical, military, and intelligence expertise to improve arms control compliance, export controls, inspection and monitoring, interdiction of shipping for inspection, during periods of crisis, and otherwise strengthening the norms and incentives against acquisition in the first place.

- To protect U.S. interest and forces, and those of its allies, from the effects of WMD in the hands of hostile forces through assuring that U.S. forces have the equipment, doctrine, training, and intelligence to confront an opponent with WMD on some future battlefield should that prove necessary.

Question. What are the cost estimates associated with DOD's approach to counterproliferation?

Answer. First it's important to understand that those things underway in the Department to support counterproliferation are not represented anywhere as one monolithic line item. Counterproliferation is not a single project the Department is doing, but is better described as a mission the Department has developed to meet the need to protect U.S. forces who deploy to regions where proliferation of weapons of mass destruction has occurred. The closest we come to identifying specific funds are those to support OSD Policy and Acquisition in the President's budget for fiscal year 1995 (see attached) where \$30.31 million is carried as a subactivity in the Washington Headquarters Service's account. Let me emphasize, this \$30 million request, entitled DOD Counterproliferation Implementation Support, should not be seen as encompassing everything DOD is doing in counterproliferation. The Services, as well as organizations like the Ballistic Missile Defense Office all have activities underway that contribute to DOD's counterproliferation mission. The \$30 million should be viewed as funds that complement Service and Agency efforts. For example, in support of the Counterproliferation Acquisition Strategy, it would fund proof of concept studies leading to Advanced Concept Technical Demonstrations, and the costs associated with supporting DOD's counterproliferation acquisition working groups that are developing specific technology proposals in the area of counterforce, active defense, passive defense, and command, control, communications, and intelligence. That's the type of work, and a lot more, that this \$30 million is designed to facilitate.

WASHINGTON HEADQUARTERS SERVICES
OPERATION AND MAINTENANCE, DEFENSE-WIDE
Detail by Subactivity Group: DoD Counterproliferation Implementation Support

I. Narrative Description:

The proliferation of weapons of mass destruction (WMD) and their means of delivery is one of the major threats facing the United States and its allies. The Department of Defense contributes to the full range of US efforts to combat proliferation, including diplomacy, arms control, export control, and intelligence collection and analysis, but places particular emphasis on assuring that US forces and interests are protected should the US confront an adversary armed with WMD. To focus DoD's unique expertise to enhance the effectiveness of United States global counterproliferation activities, the Department has launched the Defense Counterproliferation Initiative (DCI). The DCI recognizes the prominent goal of preventing proliferation of WMD and their delivery systems, while at the same time recognizing proliferation will occur, and the US must continue and expand preparations to protect forces, interests, and allies threatened by proliferators. To support the prevention mission within the DCI, the Department requested legislative authorities to expand participation in international efforts to detect and monitor chemical and biological weapon, and delivery system proliferation as well as nuclear weapon proliferation. The DCI protection mission consists of five elements: organizing for the new mission, reviewing technologies and acquisitions to support the new mission, planning how we'll fight wars involving proliferators differently, operationalizing our intelligence capabilities, and internationalizing our protection efforts. The funds requested support the implementation of the Defense Counterproliferation Initiative, and facilitate leveraging on-going DoD programs contributing to counterproliferation activities. The dangers posed by proliferation require the US to continue to use the full range of political, economic, and military tools to prevent proliferation while at the same time, undertaking the security preparations needed to deal effectively with the military threat stemming from WMD proliferation.

In FY 1994, the Department's support of the DCI is aligned in accordance with provisions and authorities under Title XVI of the National Defense Authorization Act for FY 1994, as amended. The Department plans to fund up to \$20 million for the prevention and protection missions of the DCI. These funds will directly support the Assistant Secretary of Defense for Nuclear Security and Counterproliferation as he provides strategic vision and policy direct for the implementation of the DCI. The cornerstone of the DCI protection mission is our preparation efforts for DoD's Counterproliferation Acquisition Strategy, which is under development for the FY 94 POM submittal. DoD will accomplish studies and analysis to lay the policy foundation for support of the counterproliferation acquisition working groups for active defense, passive defense, counterforce, and command, control, communications and intelligence. For the DCI prevention mission, DoD plans to continue and expand its inspection and monitoring programs in support of UNSCOM and UN Resolutions for facilitating the destruction of Iraq's WMD and accomplishing long term monitoring of facilities and equipment related to the development, production, and employment of WMD. Additionally, these funds will support export control assistance in regions of concern beyond the Former Soviet Union. An aggressive study will be launched to explore ways to enhance our ability to block export of sensitive goods to potential proliferators, even as these goods are achieving wider commercial availability.

In FY 1995, the Department will build on the policy foundation for supporting DCI's protection and prevention missions by initiating proof of concept studies leading to Advanced Concept Technical Demonstrations (ACTDs). These studies will focus on redressing military capability shortfalls thus permitting US forces to operate effectively in a WMD environment. These funds will also support acquisition studies and the building of analytical tools to keep US technology initiatives ahead of the proliferation breakthroughs resulting from the greater commercial availability of relevant technologies and know-how to proliferators. To continue the Department's support of prevention initiatives, DoD will fund detection, monitoring, and elimination programs targeting the proliferation of nuclear, chemical, and biological weapons and their means of delivery. DoD will continue the study program launched in FY 1994 for enhancing US abilities to block export of sensitive goods to proliferators.

II. Description of Operations Finances:

The following programs and related studies will be supported in FY 1995:

- (1) Counterproliferation Acquisition Strategy implementation support.
 - (a) Proof concept studies leading to Advanced Concept Technical Demonstrations (ACTDs).
 - (b) Support to counterproliferation acquisition implementation working groups for active defense, passive defense, counterforce, and command, control, communications, and intelligence.
- (2) Activities of the United Nations Special Commission on Iraq (UNSCOM).

WASHINGTON HEADQUARTERS SERVICES
OPERATION AND MAINTENANCE, DEFENSE-WIDE
Detail by Subactivity Group: DoD Counterproliferation Implementation Support

II. Description of Operations Financed (Cont.)

- (a) Aerial surveillance, technical expertise, and logistics support.
- (b) Assistance in detecting through air sampling and other means, clandestine Iraqi efforts to produce chemical agent or precursor.
- (c) Assistance in the establishment of a country-wide camera surveillance capabilities to monitor Iraq's key dual use facilities capable of producing WMD.
- (d) Analyses of samples taken to verify Iraqi compliance with UN Resolution 715.
- (e) Chemical weapon and ballistic missile destruction.
- (f) Nuclear materials control and removal.
- (3) Safeguard programs of the International Atomic Energy Agency.
 - Equipment for special and other non-routine activities (e.g., Gamma-Ray and neutron detection equipment, radiation monitors, and containment and surveillance equipment).
- (4) Development of effective export control systems in Eastern Europe, the Baltic states, South America, the Middle East, East Africa and the Pacific Rim.
 - Training, technical assistance, and provision of equipment to assist in the development of indigenous, multi-purpose export control programs.
- (5) Support for threat reduction programs to include destruction and elimination of WMD and their delivery systems in Eastern Europe and other areas of the world outside the former Soviet Union as required.
 - Destruction, dismantlement, and/or elimination of WMD and missile delivery systems including launchers and support equipment.
- (6) Related studies and analyses.
 - (a) Implications for the prevention and protection missions of the Defense Counterproliferation Initiative of widespread availability of previously controlled sensitive technologies and know-how.
 - (b) Assessment of political, technological/economy, and military dynamics within regions where proliferation is occurring, how proliferation affects stability within the region, and how DoD could buttress regional stability as affected by WMD proliferation.
 - (c) Analysis of ways to enhance our ability to block export of sensitive goods to countries of concern through a better understanding of black-market activities, technology chokepoints, limits on availability of weapon-usable fissile material, implications of availability of technology spin-offs from space launch programs, etc.

III. Financial Summary (O&M: \$ in Thousands)

A. Subactivity Group:	FY 1991	FY 1994		Current Estimate	FY 1995 Budget Request
		Budget Request	Appropriated		
DoD Counter-proliferation Implementation Support	0	0	0	0	30,310
B. Reconciliation Summary:			Change FY 1994/1991		Change FY 1995/1991
Baseline Funding			0		0
Price Change			0		0
Program Changes			0		30,310
Current Estimate			0		30,310

Question. What new capabilities does counterproliferation imply?

Answer. The best way to answer this question is in the context of the Bottom-Up Review, and our Desert Storm experiences with the four aspects of proliferation; nuclear, chemical, and biological weapons, and their means of delivery.

First, the Bottom-Up addressed remaking U.S. forces to maintain our unmatched conventional capability. Because proliferation of weapons of mass destruction and their means of delivery threaten this conventional superiority, the DCI was instituted to ensure our commanders are equipped to effectively oppose a WMD-equipped opponent.

This need to support our commanders better was brought home to us in Desert Storm. Even though that conflict had a very satisfactory outcome, we encountered some surprises that in different circumstances could have made the outcome much less satisfactory. First, we discovered a larger and fundamentally different nuclear program than our assessment had originally led us to believe. Second, when we considered attacking stored biological agent, we learned how little we knew about the collateral consequences of such an attack. Third, we learned how quickly the military ineffective SCUD, could divert significant military capability for due to the potential for dire political consequences.

Just from these examples you can begin to understand the need for different and expanded battlefield and theater intelligence regarding WMD. The need to be able to strike deeply buried targets, and mobile SCUD launchers are just two other examples in our things to do category. As we continue to assess our existing capabilities against requirements to protect our forces from WMD, additional counterproliferation capabilities will emerge.

WRITTEN QUESTIONS FROM SENATOR DOMENICI TO SECRETARY PERRY AND THE RESPONSES

Question. How many divisions does DOD require for a MRC-East (e.g. the Persian Gulf) scenario? How many divisions does DOD require for a MRC-West (e.g. Korea) scenario? Given the presumption of near simultaneous scenarios, is there a shortfall between the requirement for Army divisions and the 10 divisions planned under the Bottom-Up Review?

Answer. The Bottom-Up Review (BUR) analysis indicated that each of the two MRCs could be won with four or five active Army divisions working in concert with the U.S. Air Force, U.S. Navy, U.S. Marine Corps and forces from regional friends and allies. This analysis assumed that certain critical enhancements, such as preferred munitions and increased strategic air and sealift, existed and were available. Hence, in the expected cases, 10 active Army divisions are sufficient to meet the two MRC requirements.

Nevertheless, should an MRC require more forces than we expected, we have built in hedges to deal with this contingency. The BUR postulated that each MRC could, in the adverse case, require up to an additional two divisions. If two adverse case MRCs occurred at the time, the requirement would be for 12 to 14 divisions. The BUR acknowledged that the U.S. must be ready to meet the unexpected by providing for 15 enhanced readiness combat maneuver brigades in the Army National Guard, each of which could be combat ready 90 days following its respective call-up date. These 15 brigades translate into five division "equivalents"—more than would be needed even if two adverse MRCs occurred.

As a result, we are confident that the Army's 10 active divisions, coupled with the 15 enhanced readiness brigades from the Army National Guard, will be capable of meeting the requirements of the two MRC strategy.

Question. What is the programmed strategic lift requirement under the Bottom-Up Review? Is a shortfall projected in lift requirements? If so, when will the shortfall be closed?

Our plans call for substantial enhancements to our strategic mobility—many of which were first identified in the 1991 Mobility Requirement Study (MRS). First, we will continue the program to procure and deploy the C-17 airlifter to replace our aging C-141 transport fleet. While we will continue to monitor the troubled C-17 program closely, we nonetheless require modern, flexible airlift capacity to be able to execute our defense strategy. The Defense Acquisition Board agreed to purchase 40 C-17s through fiscal year 1996, taking the program through initial operational capability. A decision on further procurement of C-17s or an existing wide-body military or commercial cargo aircraft is dependent upon contractor and aircraft performance through flight test and reliability, maintainability, and availability assessment.

Second, we plan to store a brigade set of heavy Army equipment afloat; the ships carrying this material would be prepositioned in areas from which they could be

sent on short notice to either the Persian Gulf or Northeast Asia. Other propositioning initiatives such as prepositioning additional Army heavy forces would accelerate the arrival of heavy Army units in Southwest Asia and Northeast Asia.

Third, we will increase the capacity of our surge sealift fleet to transport forces and equipment rapidly from the United States to distant regions by purchasing additional roll-on/roll-off ships.

Fourth, we will improve the readiness and responsiveness of the Ready Reserve Force (RRF) through a variety of enhancements. Finally, we will fund various efforts to improve the "fort-to-port" flow of personnel, equipment, and supplies in the United States.

However, significant changes have occurred since the MRS was first published in January 1992. Most of these changes have resulted from the comprehensive review of U.S. defense strategy, force structure, modernization, infrastructure, and foundations conducted in the BUR. Other changes have resulted from major airlift and sealift program acquisition delays and decisions. As a result, the Joint Staff is beginning a year-long study to update the MRS to ensure that currently programmed lift is adequate to support our strategy, particularly our ability to fight and win two nearly simultaneous MRCs.

Question. The Congressional Budget Office testified before the Budget Committee on March 9, 1994. Their testimony dealt with "Options for Reconfiguring Service Roles and Missions." In that testimony they present options for changing the division of labor among the services. These options are presented in Table 3 of their prepared testimony.

Please comment on the advisability of adopting each of these options, as well as the projected budget savings.

Answer. The Congressional Budget Office (CBO) study on "Options for Reconfiguring Service Roles and Missions" outlines a number of alternatives proposals for changing the assignment of Service roles and missions. The study further links changes in roles and missions directly with reductions in force structure and associated costs savings. The CBO study recognizes that each of the identified alternatives is notional in the sense that a reduction in one set of military capability (as a result of a change in assignment of roles and missions) would often require an offsetting increase in other capability to maintain a comparable level of military effectiveness. For the most part, the study does not identify these offsetting capabilities or the impact these would have on projected savings. However, it would be safe to say that net savings would be considerably less than those projected.

The Department fully agrees with CBO that the proper assignment of roles, missions, and functions to the Services and combatant commands is a critically important task. The Department also agrees that unnecessary duplication among the Services must be eliminated. Indeed, these very considerations helped to inform Secretary Aspin's decision on General Powell's roles and missions report and guided the Department's deliberations throughout the Bottom-Up Review. These considerations also underpin the Department's support to the newly announced Commission on Roles and Missions of the Armed Forces.

However, the Department differs with the CBO on overall approach. Strategy must guide overall force requirements. So, too, must strategy guide considerations of change in the assignment of roles, missions, and functions that have the potential to result in changes in force structure. This link between strategy and forces, which is so crucial to the Department's analytic approach, appears lacking in the CBO assessment.

Question. There have been allegations that \$15 to \$18 billion in unallowable costs have been charged to government defense contracts. Are these allegations accurate?

Answer. No; the estimate was developed by projecting results from a GAO review of six small defense contractors to all audits of overhead costs that the Department of Defense will complete from fiscal year 1991 to fiscal year 1996. This projection is invalid for a number of technical reasons. However, the underlying deficiency is that the sample used by GAO was too small, and by GAO's own admission not necessarily representative of small contractors. To project the results to large defense contractors, where the government has an on-site staff that conducts continuous reviews, is even less supportable.

Question. Shouldn't acquisition reform help your efforts in this area?

Answer. Generally yes. Acquisition reform will result in purchasing more materials and services using commercial buying practices. The regulation of the marketplace should serve as a significant deterrent to incurring unallowable costs.

Question. Do unallowable costs in overhead submissions translate directly into government overpayment on contracts?

Answer. Generally no. As work progresses, costs are billed to the government based upon overhead billing rates which are established at levels that seek to ex-

clude amounts for unallowable costs. Also, by the time final payment is made on defense contracts, the unallowable costs will have been eliminated.

Question. Based on GAO's claims, is DOD failing to properly audit defense contracts?

Answer. No; the Defense Contract Audit Agency (DCAA) assesses the risk to the government at each contractor location to determine the extent of audit effort needed to provide reasonable assurance that material unallowable costs would be detected. This risk assessment is influenced by a number of factors including the types of government contracts and total indirect cost allocated to government contracts; the adequacy of a contractor's policies, procedures and internal controls; and, the adequacy of the accounting records. The audit effort at four of the locations reviewed by GAO was appropriate based on the assessed risk to the government. At one of these four locations, the adjustable (non-firm fixed price) government business amounted to only $\frac{1}{10}$ of 1 percent of its total business base. At this location, for every \$100 questioned by GAO the government could recover 70 cents.

GAO did identify a single DCAA office, which was responsible for auditing two of the six small contractors, that had not followed established procedures for auditing small contractors. Corrections have been made to the audit procedures followed by that office.

It should also be noted that DCAA has revised its audit guidance and added the requirement to perform transaction testing on all of its audits of small defense contractors. This action, which was underway before the GAO review, increased the amount of testing DCAA performs at such locations.

Question. What is the Department's position on the GAO audit report?

Answer. The Department's position is contained in its official response to the final GAO report. The main points in that response were:

- GAO reviewed audits from a total of 58 contractor locations before focusing on the six selected contractors. The 58 contractors voluntarily removed over \$60 million from their indirect cost claims for those years reviewed by GAO. DCAA identified an additional \$17 million of costs inappropriately claimed by the contractors for those years.
- GAO failed to acknowledge the extent to which its findings would be affected by the government participation percentage at each location, i.e., the portion of the total indirect cost that would be allocated to government contracts. Those percentages range from a high of 89.0 percent to a low of 0.7 percent. When factored for government participation, the \$2 million in GAO questioned costs decreased to about \$800,000.
- The GAO report implies that all potentially unallowable costs must be excluded from contractor submissions which is contrary to the Federal Acquisition Regulation. Only those costs that are expressly unallowable costs or mutually agreed to be unallowable must be identified and excluded from any submission. Most of the questionable costs identified by GAO were not expressly unallowable. These questionable items are subject to negotiation and will require resolution by the contracting officer.
- Although it is recognized that there were some weak internal controls at the six contractors, it should also be recognized that the six voluntarily identified and excluded \$16 million from their cost submissions in the years reviewed by GAO.

Question. Is the 1995 FYDP too high in light of the GAO audit findings?

Answer. No; there is an indirect relationship between the GAO audit findings and program cost estimates included in the FYDP. In general, FYDP estimates are developed by applying judgment/estimating relationships to historical information. These estimates of costs that will be incurred in the future do not get to a level of detail where unallowable costs would be identified.

However, in some instances, program estimates do incorporate the impact of agreed to forward pricing rates from which unallowable costs have been eliminated. This is because the forward pricing rates have been developed based on anticipated allowable costs.

It should also be noted that costs ultimately billed to the government are based upon billing rates which seek to exclude amounts for unallowable costs, and by the time final payment is made, unallowable costs will have been eliminated.

Finally, the controls that have been put into place such as requiring contractors to certify that the costs they are submitting are allowable, and penalizing contractors when expressly unallowable costs are included in their submissions, help to ensure that contractors delete any unallowable costs that are incurred. We believe that progress has been made, but we will continue to apply management attention to get the problem resolved.

Question. Dr. John Steinbruner testified before the Budget Committee on March 9, 1994. He claimed that DOD plans are \$37 billion below the full financing criterion over the course of the 5 year defense plan. Is this claim accurate?

Answer. No; when finalizing our fiscal year 1995-99 FYDP, we estimated a funding shortfall due to higher inflation at \$20 billion for the period. Other than this shortfall, the FYDP itself is fully financed in the sense that it is priced according to realistic program estimates and the latest inflation estimates. It makes no assumptions about management savings unless they can be convincingly documented.

Question. Dr. Steinbruner also argued "that the United States will eventually be driven to a fundamental shift of policy in response to new security conditions and that additional force reductions will accompany that change." He argue that "the currently projected defense budget could be reduced by cumulative total of \$247 billion over the 5-year plan (with a 1999 defense budget \$80 billion lower than planned.)" Please comment on the advisability of adopting a defense spending plan as described by Dr. Steinbruner.

Answer. President Clinton, military and civilian defense leaders, and many Members of Congress believe that the Administration's defense spending plan cuts about as deeply as is prudent, given the current state of global affairs. Reductions on the order proposed by Dr. Steinbruner would fundamentally change the character of America's military posture, make our new strategy unsupportable, call into question our ability to fulfill U.S. commitments to our allies, and undermine America's global leadership.

WRITTEN QUESTIONS FROM SENATOR GRASSLEY TO SECRETARY PERRY AND THE RESPONSES

Question. Does the DOD believe that current plans will provide sufficient munitions to support a major regional conflict? That in the event of hostilities, a surge production will not be required?

Answer. We believe that the DOD munitions stockpile, combined with funded due-in deliveries, will contain sufficient modern and suitable substitute munitions to support a major regional conflict. Further outyear funding will continue to buy more of the newest/latest configuration munitions items available today but at reduced rates. In the event of hostilities, the DOD will fight using the existing munitions stockpile; projected threat scenarios do not require production surge from the industrial base. However, we might surge to provide more of some preferred munitions and to restock for future contingencies.

Question. If the DOD does not believe current plans will provide sufficient munitions if there is a major conflict, what plans are being made to address this matter?

Answer. The DOD munitions stockpile contains sufficient munitions to support a major regional conflict.

Question. Questions have been made about the state of the munitions industrial base. What is your view on this matter?

Answer. The conventional munitions industrial base is undergoing a significant reduction in capacity as well as willing participants—both government and commercial. I believe this reduction is being conducted in a rational manner by the U.S. Army in its capacity as the Single Manager for Conventional Ammunition. DOD has provided a report to Congress that addresses the munitions industrial base. However, the DOD is conducting further analysis in a comprehensive ammunition industrial base review which may fall for some minor fiscal year 1995 reprogramming actions in this area.

Question. What is the status of the DOD report to Congress requested March 1?

Answer. The DOD report to Congress was forwarded to the four Congressional Committees on April 29, 1994 by Mr. Longuemare, the Principal Deputy Under Secretary of Defense (Acquisition & Technology).

Question. There is concern that the fiscal year 1995 FYDP is either consistent with the President's fiscal guidance nor reflects the most likely cost of the defense program proposed. I would appreciate your response to the following: DOD has quantified the range of error in its outyear inflation estimates as roughly \$20 billion. The over programming as a result of the inflation issue is dealt with through the use of negative accounting entries for fiscal year 1996-99. Please identify any other negative accounting entries used in the FYDP; the accounts in which they are used; the amounts by fiscal year; and the reason why the total amounts in the affected programs are offset by the use of these negative entries.

Answer. The \$20 billion shortfall is handled with a single budget line, called "Undistributed Adjustments". There are no other accounting entries reflected in the fiscal year 1995-99 FYDP.

Question. What is the range of potential error associated with other major FYDP assumption, such as: underestimating the potential for weapon system cost growth; slower than planned base closures; potential increases in the cost of environmental clean-up and compliance; failure to achieve cost savings of planned management initiatives like the National Performance Review and Defense Management Report (DMR)?

Answer. There are no major FYDP assumptions that DOD believes carry a significant potential error. Before the FYDP was finalized, the Department made adjustments in all areas, such as DMR initiatives, in which projected savings could not be validated.

Question. Is it possible that the overprogramming in the outyears is not \$20 billion but more like \$50, \$75, or \$100 billion or more?

Answer. DOD believes that \$20 billion is a valid estimate, given current economic projections. Future changes in inflation projections could of course raise or lower the cost of funding the FYDP.

Question. If there is overprogramming in the outyears, does it mean that the fiscal year 1995 budget is sustaining unaffordable programs that should be eliminated? Is any of the advance procurement money for fiscal year 1996 and beyond hooked up to the "future adjustments?" How do you know?

Answer. Neither the fiscal year 1995 budget nor the fiscal year 1995-99 FYDP are sustaining any unaffordable programs. No advance procurement money is tied to future adjustments; the money is for programs that DOD expects will be funded adequately.

Question. The last FYDP submitted to Congress was the fiscal year 1992-97 FYDP, dated February 23, 1991. That FYDP assumed \$172 billion in savings and reductions as follows: \$82 billion from proposed program terminations; \$70 billion in anticipated DMR savings; \$19 billion in unidentified savings, including \$8 billion in savings from base closures. To what extent were these savings realized? If these savings were not realized, as I suspect, then there must be offsetting reductions, and the magnitude of these cuts has grown under President Clinton's defense plans.

Answer. When the Clinton administration took office, the new DOD leadership was skeptical about the accuracy of the previous Administration's projections for management savings and program costs. Therefore, in modifying the Bush/Cheney defense program to prepare President Clinton's fiscal year 1994 defense budget, a \$10 billion offset for fiscal year 1994-97 was included, as an estimate of the savings that DOD was sure it could not guarantee. At the same time the Odeen Panel was convened to determine more definitively the validity of the assumptions underlying the Bush defense program we inherited. For the Bush program, the Panel estimated the fiscal year 1994-97 shortfall to be \$12 to \$16 billion: \$9-\$11 billion for unrealizable DMR management savings; \$2-\$3 billion for underestimated weapons costs; and \$1-\$1.5 billion for underestimated environmental cleanup and compliance costs.

After the Odeen Panel reported its findings, OMB added \$13 billion to the DOD topline for fiscal year 1995-99. DOD's fiscal year 1995-99 defense budget projections now include only those savings that we believe we can deliver, as well as sound projections of future weapon costs.

Question. Your speech to the C. Crows suggests you are ready to give the FYDP to industry. As you may remember, many of those swept up in the Ill Wind investigation were charged with illegal possession of the FYDP. Is it a good idea to give the FYDP to industry? How would you decide who in industry would get it?

Answer. The printed transcript of that speech, which may be the basis for your question, does not reflect what I said or meant to say. My message was that an accurate FYDP—a central goal of this DOD leadership—is essential to DOD program managers, who indeed would have access to the actual plan. With an accurate FYDP to consult, program managers in turn will be better able to help the defense industry assess their future market more reliably. However, DOD's assistance to defense industry forecasting does not need to include providing it with copies of the FYDP.